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www.MicroSave.net
info@MicroSave.net

Drop-outs Amongst Ugandan Microfinance Institutions

By

**Graham A.N. Wright, Leonard Mutesasira, Henry Sempangi
David Hulme and Stuart Rutherford**

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Executive Summary

Background:
There is evidence that MFIs operating in Uganda are experiencing high (often in excess of 25% per annum) levels of drop-outs amongst the clients. This is significantly in excess of drop-out rates amongst most Asian, Latin American and West African MFIs, and has negative implications for efforts to achieve operational/financial sustainability.

The Study:
The purpose of this study was to improve knowledge and understanding of why MFIs in East Africa suffer high levels of drop-out (or turn-over) among their clients, and thus to facilitate MFIs' efforts to address this problem.

Methods:
This study used qualitative research methods, in particular in-depth interviews, Focus Group Discussions and a variety of Participatory Rapid Appraisal techniques with people who are clients of a variety of MFIs.

MicroFinance Institutions Reviewed:
The researchers held discussions with the management, credit officers, clients and ex-clients of PRIDE, FINCA, Faulu, FOCCAS and Centenary Rural Development Bank.

Geographic Scope:
The study was conducted in a wide variety of settings throughout the cities of Kampala and Jinja, in the towns of Mbale and Tororo, and in rural areas round Jinja, Mbale and Tororo.

Defining Drop-outs:
There are several categories of "drop-out" amongst those that leave MFIs in Uganda. Some leave voluntarily and others are "pushed" either by the MFI's credit officers or by group members. A third category are simply "resting" from the rigours of taking a loan repayable on a strict weekly instalment basis and do not think that they have "dropped out" at all, and indeed are busy planning how they will use their next loan.

Data on Drop-outs:
The data showed that over the last year, an average of just under 5% of FINCA's clients "drop-out" (or often "rest" every month). Similarly, an average of just under 5% of PRIDE's clients "drop-out" (or more generally are "pushed out") every month. Faulu's drop-out rate is lower and has fallen to around 17% since the introduction of a more liberal savings withdrawal policy implemented a few months ago. FOCCAS monitor their drop-outs at the end of each cycle and estimate the rate of drop-outs to be about 3-5% per 16 week cycle. It is much more difficult to assess the level of drop-out from Centenary Bank, since those denied or not wishing to take follow-on loans simply maintain their savings account with the bank.

Socio-economic Profile of Drop-outs:
The evidence from the field suggests that the primary reasons for drop-out vary according to the socio-economic status of the clients leaving the programme, as well as whether they live in an urban or rural setting.

Relatively Well-Off Drop-outs
In the urban environment, one of the primary reasons for "dropping-out" is to **seek higher loans**, usually on an individual basis. In many cases richer clients are moving their business to Centenary Bank: it provides savings services and larger loans on an individual basis without the **time-consuming weekly meetings**.

Many clients complained that the relatively large sums that they had locked in their compulsory savings accounts had resulted in a net drain of their working capital. The more affluent, longer term members often left because they reached a stage where they felt (correctly) that they were simply **borrowing their own savings** back from the institution. Many clients are also using these high levels of locked-in **compulsory savings as a disciplined savings** system to build-up lump sums for major acquisitions, typically of land or for house-building. Once the target has been achieved, the clients plan to drop-out and leave the MFI. However, several clients complained that the MFIs' systems and sometimes even their credit officers prevented them from **accessing their voluntary savings** in times of emergency, and this has on occasions been the basis for clients to drop-out.

Not-so-Poor Drop-outs
The not-so-poor drop-outs seem to leave or be forced out as the loan and thus **weekly repayment size** mounts. Officers in almost all the institutions the research team visited noted that by the 3rd and 4th cycles, many clients began experiencing problems meeting the weekly repayments. Several groups have responded by setting up Accumulating Savings and Credit Associations amongst themselves to pool funds and advance credit to those struggling in any given week.

In addition, in the rural setting people are more vulnerable to **seasonal variations** in income/expenditure flows and have fewer opportunities for making money than the urban settings where there are more opportunities to diversify. The research team believes that it is these seasonal variations, together with the rising loan sizes and most MFIs' rigid loan disbursement systems, that require clients to take loans at a specific date or not at all, has lead to many clients opting out or "**resting**". This phenomenon is particularly common in the rural areas, and (in part at least) explains the remarkably high levels of drop-outs amongst MFIs in Uganda.

Poor Drop-outs
Poorer drop-outs leave or are pushed out from MFIs primarily because they find **problems repaying their loans**. It is reasonable to speculate that they have fewer, less diversified sources of income with which to manage the weekly repayments. There does seem to be a common practice of culling the poorer, weak repayers in the early cycles amongst all the MFIs a reality reflected by one branch manager who noted, "Exits are like weeding – if you don't weed, you don't get a good crop".

In addition, the poor are more prone to **illness** and **death** in their (perhaps larger) families, two other strikingly common causes of drop-out. Often drop-outs on the basis of these problems seem to temporary and when the client has recovered from or responded to the crisis, she returns.

Other Issues not Specific to Socio-Economic Groups
A very common theme was the dislike of the system of **attaching savings**, particularly since this has now been almost universally extended to include not just the sub groups of (typically) five but also the larger groups by some MFIs operating in Uganda. This can also lead to **groups "unzipping[1]"** and the loss of many good quality clients.

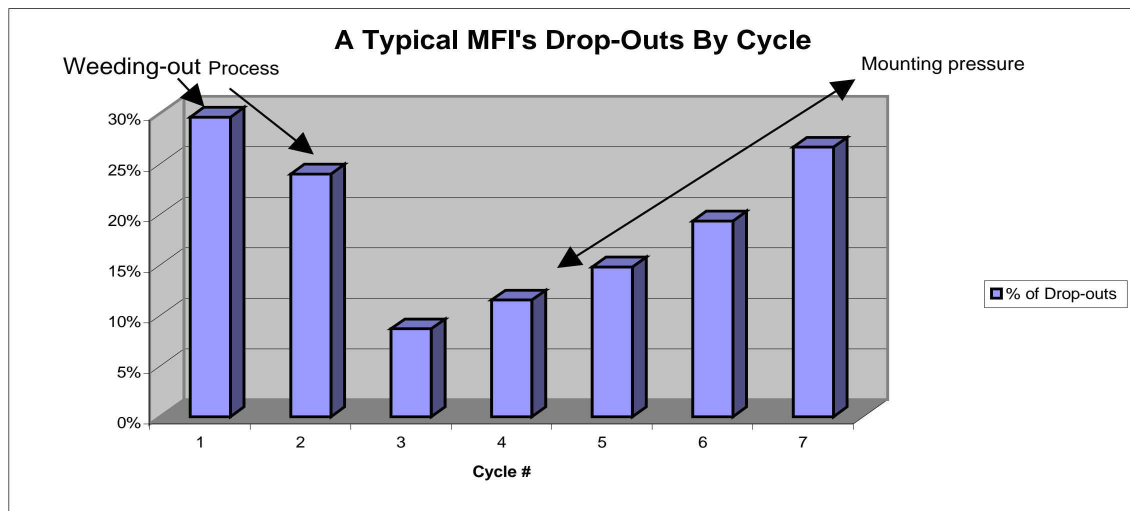
Another complaint amongst clients was with the way that some **credit officers made decisions**. In several of the MFIs studied credit officers have been given latitude to assess the clients' capabilities to service loans and take decisions on the size of the loan to be issued. This has caused some dissatisfaction and drop-out, particularly in the context of issues surrounding clients' perceptions that they are paying to borrow their own savings.

In almost all the MFIs reviewed there is a tendency of **credit officers to refer all problems back to the group**, leaving the onus on the group and its leadership to resolve them. This has caused high levels of dissatisfaction, particularly in view of the fact that often the problems arise from enquiries about disparities in book-keeping, attached savings or delayed disbursement of loans.

It is interesting to note that despite the concerns expressed by many practitioners, there seems little evidence for large numbers of people joining MFIs on a **speculative basis** to see whether they could get away without repaying the loans. While there were isolated reports of this, it was not a wide-spread recurring issue.

There is limited evidence to suggest that there are any significant differences in the **gender of drop-outs**.

In Summary:
In summary the research team hypothesise that the typical amalgamated pattern of the MFIs which it reviewed the pattern of drop-outs can be summarised as follows:



[1] The "unzipping" effect (a term first used by Rutherford in 1992) is when the guarantee group, and indeed often the entire larger group, burdened by excessive or multiple default, sees no further hope for continuing loans and elects to default *en masse*, thus causing the group (and the group guarantee that held it together) to "unzip".

In this diagram the drop-outs in the first two cycles arise primarily from those clients who are finding out whether they can manage the weekly repayment regime and MFIs with aggressive "weeding out" policies. The rise in the number of drop-outs in the latter cycles arises primarily from clients facing problems with the rising weekly repayments, tiring of weekly meetings and frustration with "borrowing their own savings back".

Who Does Not Join And Why?

The rich are said not to join since the loan amounts made available are too small to be worth all the effort. In addition, the weekly meetings are viewed as being too time consuming and onerous for "busy mobile businessmen [sic]". **The not-so-poor** find the services useful because they have small businesses that are short of capital and they sometimes have domestic problems and need money to deal with these. These are therefore the main participants in the schemes. It should however be noted that the not-so-poor remain vulnerable. Critiques of microfinance based on "not reaching the poorest" tend to overlook the dynamic nature of poverty. There are relatively few of **the poor** in the groups for a variety of reasons that span exclusion by the MFIs' staff to self-exclusion by the poor themselves.

Discussion/Recommendations:

Amongst MFIs operating in Uganda there appears to be a culture of assuming that the clients are going (possibly even want) to default. As a result, the MFIs prefer "**sticks over carrots**" as a method to encourage repayment. MFIs' clients are becoming increasingly discerning and keen to seek out the MFI that provides the best possible services for their needs.

There is growing evidence that despite the rhetoric surrounding "**group guarantee**", it is not proving as effective as its advocates suggest - particularly after the first two or three loan cycles have been completed. At present few of the systems and products on offer in Uganda can be described as client-friendly. With the growth of competition (at least in the more densely populated parts of Uganda) there is a pressing need for forward-looking MFIs to change if they wish to retain and grow with their clients. In the face of increased competition, MFIs will have to **design products that are responsive to their clients' needs**. MFIs in Uganda are serving a broad spectrum of clients, from relatively wealthy, urban clients to reasonably poor rural clients, and (in rhetoric at least) seek to serve the poor members of the community. This **diversity of clients** in turn necessitates a diversity of products.

On the basis of the evidence gathered by the research team, there is probably a case for using a relatively strict and disciplined group guarantee-based system in the first few cycles in order to screen out those that cannot or will not repay the loans. Thereafter, MFIs seeking to retain richer (high-value, high profit) clients will probably have to make a move towards **individual-based lending**. MFIs seeking to retain not-so-poor clients will have to pay more attention to the seasonality issues and examine options for offering **longer term loans** so that the weekly instalments remain small enough to be manageable from the clients' household budget. For the not-so-poor and the poor, there is also likely to be a case for small **short-term emergency loans** in addition to saving services.

It is time to think seriously about offering **voluntary, open-access, unattached savings services** for which there is a huge demand. Given the high levels of drop-outs resulting from illness/death in the family, it is also time to look at **insurance mechanisms**.

Associated with transforming a traditional credit-giving MFI into a client service oriented financial service organisation is the challenge of **improving the quality of service** given by the credit officers.

All of the above requires careful **systems and product development**, a process that is not easy. The first steps are: (i) to get a better understanding of the market, the needs and opportunities of the clients (and potential clients) the MFIs are (or could be) serving; and (ii) to get a better understanding of the competition (in both the formal and informal sectors), its systems and products.

In addition to formal market research, the MFIs should use their own **institution-based information**.

Drop-Outs Amongst Ugandan MFIs

Graham A.N. Wright, Leonard Mutesasira, Henry Sempangi, David Hulme and Stuart Rutherford

INTRODUCTION

Background:

There is clear evidence that many of the MFIs operating in Kenya, Tanzania and Uganda are experiencing high (often in excess of 25% per annum) levels of drop-outs amongst the clients (personal discussions in 1998, Munyakho, 1996 and Rutherford and Mugwanga, 1996). This is significantly in excess of drop-out rates amongst most Asian, Latin American and West African MFIs, and has negative implications for efforts to achieve operational/financial sustainability.

Members "dropping-out" or leaving an MFI cost the organisation dear - both in terms of lost investments in initial training and in terms of the opportunity costs of losing the older, more experienced members most likely to take larger loans. The surprisingly high drop-out rates experienced by East African MFIs may be indicative of the inflexible financial services they provide to their clients. The recent research into drop-outs in Bangladesh (ASA, 1996; Chowdhury, A.M.R., and Alam M.A., 1997; Evans et al., 1995; Hasan, G.M. and N. Shahid, 1995; and Hashemi, 1997) strongly suggests that members leaving MFIs are usually doing so because they are dissatisfied with the quality of financial services being offered by the organisation … or have found better services being offered by another one. This is a view supported by many market-oriented commentators (e.g. Jackelen, 1997). Clients "shopping around" for the best services in this way has also led to prevalent "multiple membership" of the same clients with different MFIs – a phenomenon that seems to be on the rise in parts of East Africa too. Clients with multiple membership are absorbing huge costs (particularly in terms of the time they must spend at meetings) just in order to get access to the financial services they feel they need - a larger loan or open-access savings facilities. Indeed, MFIs offering more flexible financial services better tailored to meet clients' needs may be able to charge a premium for these services.

The Study:

The purpose of this study was to improve knowledge and understanding of why MFIs in East Africa suffer high levels of drop-out (or turn-over) among their clients, and thus to facilitate MFIs' efforts to address this problem. Specifically the study will:

1. analyse the socio-economic characteristics of drop-outs;
2. review the reasons for drop-out amongst clients including those that have switched between MFIs;
3. examine reasons why poor people eligible to join MFIs in the areas where they are operating choose not to; and
4. seek out MFI clients who have joined two or more MFIs at the same time and (if any are found) examine their motivation for doing so.

Methods:

In addition to reviewing (the largely limited) studies already completed, this study used qualitative research methods, in particular in-depth interviews, Focus Group Discussions and a variety of Participatory Rapid Appraisal techniques with people who are clients of a variety of MFIs (formal sector banks with deepened outreach and NGO-MFIs). The researchers also conducted in-depth interviews , Focus Group Discussions and some Participatory Rapid Appraisal techniques with

poor people who are no longer members of these MFIs, and those who have never joined an MFI to discover why they have taken these decisions. Details of these methods are attached as Appendix 1.

This allowed the research team to come up with:
1. An analysis and description of the characteristics of clients dropping out from MFIs (length of membership, gender, age, income-bracket, type of business etc.);
2. An analysis and description of the reasons for drop-out or switching between MFIs;
3. An analysis and description of the reasons for eligible poor people not choosing to join MFIs; and
4. Recommendations for MFIs seeking to reduce the level of drop-outs they are currently experiencing, particularly those seeking to introduce or diversify products into their portfolio of services.

The Ugandan MicroFinance Sector:
The Ugandan MicroFinance sector is relatively young (the typical MFI only started operations 3-5 years ago) but remarkably dynamic. There are around 70 MFIs typically competing for business in the more densely populated parts of the country, typically along the roadsides of the strip between Mbale and Mbarara. It is estimated that as of early 1999, around 100,000-110,000 clients are being served if all MFIs are included.

The MicroFinance industry in Uganda is particularly interesting in that it in addition to the well-established FINCA/Grameen inspired models contains two commercial sector banks (Centenary and Co-operative) seeking to deepen their outreach to serve poorer clients[2]. Furthermore Centenary Bank lends on an individual, collateral-secured basis.

The largest MFIs and their estimated number of clients are as follows:

MicroFinance Institution	Approx. # of MicroFinance Clients
PRIDE	20,000
FINCA	17,000
Uganda Women's Finance Trust	9,000
FOCCAS	7,000
UGAFODE	3,000
UWESO	3,000
Faulu	4,000
Co-operative Bank	10,000
Centenary Bank	11,000[3]

[2] Or at least did … the Co-operative Bank was taken over and closed by the Bank of Uganda as this report was being finalised.
[3] Centenary Bank has 110,000 savers – only a few of which can be classified as MicroFinance clients.

MicroFinance Institutions Reviewed:
The researchers held discussions with the management, credit officers, clients and ex-clients of PRIDE, FINCA, Faulu, FOCCAS and Centenary Rural Development Bank[4]. An over view of the operations of these institutions is attached as Appendix 2.

Geographic Scope:
The study was conducted in a wide variety of settings throughout the cities of Kampala and Jinja, in the towns of Mbale and Tororo, and in rural areas round Jinja, Mbale and Tororo.

WHO DROPS OUT AND WHY?

Defining Drop-outs

There are several categories of "drop-out" amongst those that leave MFIs in Uganda. Some leave voluntarily and others are "pushed" either by the MFI's credit officers or by group members. A third category are simply "resting" from the rigours of taking a loan repayable on a strict weekly instalment basis and do not think that they have "dropped out" at all, and indeed are busy planning how they will use their next loan.

This latter category is of particular interest since many MFIs' systems classify anyone who is not taking a loan as being no longer a member, and thus as having dropped out. As a consequence, the research team often found itself in meetings where members classified as "drop-outs" were attending simply to make savings deposits - as they had been doing every week. Neither they, nor their solidarity group members, saw them as drop-outs, for "resting" is a common phenomenon (see below). The MFIs' staff were also a little confused: resting members do not always attend weekly meetings, but often do to make savings deposits, and in theory at least their savings were still being used to guarantee the loans given to "active" members. A system that states, "If you rest, you're out" seems a little draconian, particularly when the group guarantee is in force. It is a system that has arisen from the credit-driven cultures of most of the MFIs operating in Uganda, and one that, by discounting any member not in debt to the institution, considerably overstates drop-outs.

Other MFIs have very strict loan recovery and "push-out" guidelines that force clients out after only 3 missed repayment instalments. This can result in a situation in which long-term clients of good-standing are forced out even when they have more than enough compulsory savings/loan insurance fund to cover the missed payments and the loan outstanding balances. In the event that these members wish to rejoin the MFI (and many do after a few weeks) they must start again with the smallest loan size. Once again, these re-joining members are at worst extremely short-term "drop-outs", and lead to significant overstatement of the number of "drop-outs" from the programmes.

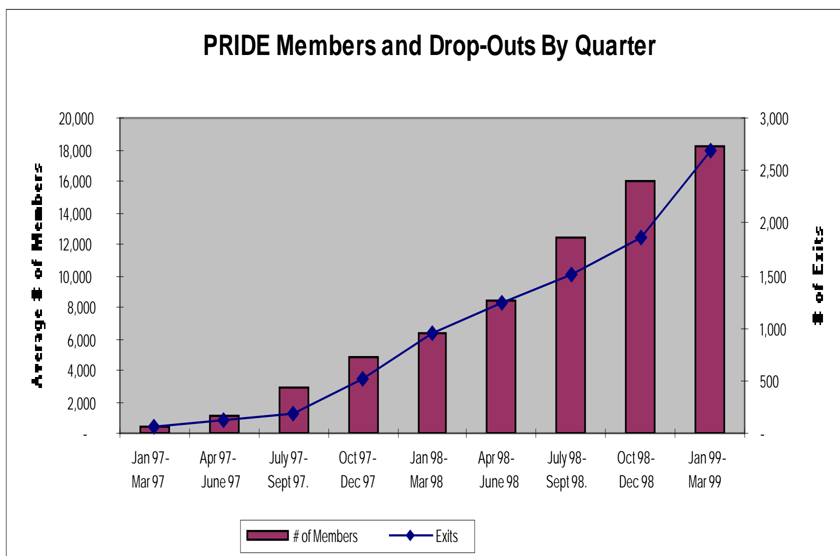
Data on Drop-outs by MFI

Most of the MFIs reviewed collect some data on drop-outs. Typically, the credit officer is required to fill out a form categorising or explaining why the client left, what loan cycle she was in etc. With many different credit officers assigning the reasons for clients leaving in a subjective manner, this data has to be treated with some degree of care and scepticism, particularly in view of the complexity of the area. The reasons for leaving assigned by the credit officers may well mask a series of inter-related reasons. For example, "business going badly" may arise from seasonal issues, illness within the family or delayed disbursement of loans by the MFI. The same stated reason may

[4] Most of the work on Centenary Bank was undertaken in Mbale where the bank's agricultural credit operation is very new. The team were therefore unable to get a good overview of drop-outs from this MFI.

be a polite way of saying "I am leaving to try out another MFI", that the weekly repayment system is too stressful or that "I have been thrown out by my fellow group members". Finally, the credit officers are (or at least were) responsible for servicing the drop-outs, and this too is likely to influence the way that they perceive the reasons for their leaving the programme.

Nonetheless, the data the research team examined from the FINCA and PRIDE (the two MFIs with computerised records on drop-outs) confirmed many of the conclusions reached during the qualitative work. In gross terms, the data showed that over the last year, an average of just under 5% of FINCA's clients "drop-out" or "rest" (see below) every month. Similarly, an average of just under 5% of PRIDE's clients "drop-out" (or more generally are "pushed out") every month. Faulu's drop-out rate is lower and has fallen to around 17% per annum since the introduction of a more liberal savings withdrawal policy implemented a few months ago. FOCCAS monitor their drop-outs at the end of each cycle and estimate the rate of drop-outs to be about 3-5% per 16 week cycle. It is much more difficult to assess the level of drop-out from Centenary Bank, since those denied or not wishing to take follow-on loans simply maintain their savings account with the bank.



PRIDE Drop-Outs Over Time

	Clients Period Start	Period End	Drop-Outs	Dropout Rate
Jan 97-Mar 97	345	472	57	13.95%
Apr 97-June 97	472	1,799	134	11.80%
July 97-Sept 97.	1,799	3,857	183	6.47%
Oct 97-Dec 97	3,857	5,662	509	10.69%
Jan 98-Mar 98	5,662	6,989	946	14.96%
Apr 98-June 98	6,989	9,803	1,235	14.71%
July 98-Sept 98.	9,803	14,904	1,515	12.26%
Oct 98- Dec 98	14,904	17,017	1,864	11.68%
Jan 99 – Mar 99.	17,017	19,398	2680	14.72%

Socio-economic Profile of Drop-outs

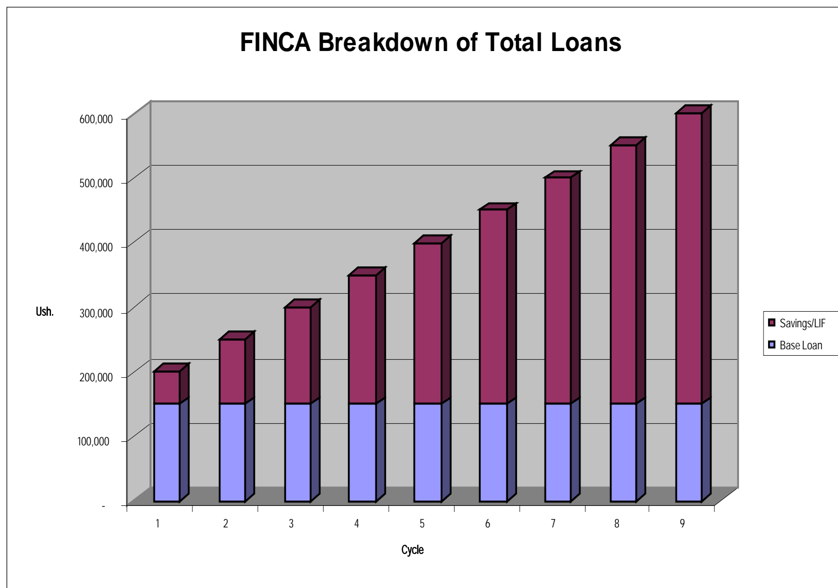
The evidence from the field suggests that the primary reasons for drop-out vary according to the socio-economic status of the clients leaving the programme, as well as whether they live in an urban or rural setting.

Relatively Well-Off Drop-outs

In the urban environment, one of the primary reasons for "dropping-out" is to **seek higher loans**, usually on an individual basis. In many cases richer clients are moving their business to Centenary Bank: it provides savings services and larger loans on an individual basis without the **time-consuming weekly meetings**. As the research team heard from two relatively affluent shop-keepers on Market Street in Kampala: "Meetings are meant to take 30 minutes, but take hours since you have to wait for latecomers and chase up people who do not come" and the meeting time was "killing my business". The search for individual loans is also linked to clients having to wait for the

disbursement of follow-on loans because of fellow group members defaulting, or the need to recruit new members in order to bring the number in the group up to the MFIs' specified minimum.

Relatively well-off FINCA clients are often seeking higher loans from the competition – the base loan is seen as too low, even where it has been increased to Ush. 150,000. This is further aggravated by the perception that the more loans you take, the more you are simply borrowing your own savings back. Indeed many FINCA clients complained that the relatively large sums that they had locked in their compulsory savings accounts had resulted in a net drain of their working capital.



This issue came up amongst clients in several of the MFIs with high levels of compulsory savings, the more affluent, longer term members left because they reached a stage where they felt (correctly) that they were simply **borrowing their own savings** back from the institution. In the words of one member, "It is good early on, it provides savings discipline and access to loans against these. Later, it is a lot of effort to merely borrow your own money".

FINCA's Figues (i)

Cycle	Total Loan	Compulsory Savings/LIF	Own Savings as % of Loan	Year
1	200,000	50,000	25%	0-Jan-00
2	250,000	100,000	40%	21-Apr-00
3	300,000	150,000	50%	11-Aug-00
4	350,000	200,000	57%	1-Dec-00
5	400,000	250,000	63%	23-Mar-01
6	450,000	300,000	67%	13-Jul-01
7	500,000	350,000	70%	2-Nov-01
8	550,000	400,000	73%	22-Feb-02
9	600,000	450,000	75%	14-Jun-02

In real terms, it is also extremely expensive. The most dramatic (but by no means unique) example is that of FINCA. Although FINCA does not hold or intermediate its clients' savings, factoring in the opportunity-cost of savings locked into the system (and therefore not available to the business) results in staggeringly high effective APR[5] interest rates that climb alarmingly as more and more of the loan value is locked away in the compulsory savings accounts. This reflects the thinking original FINCA "Village Banking" model as designed by John and Marguerite Hatch back in the

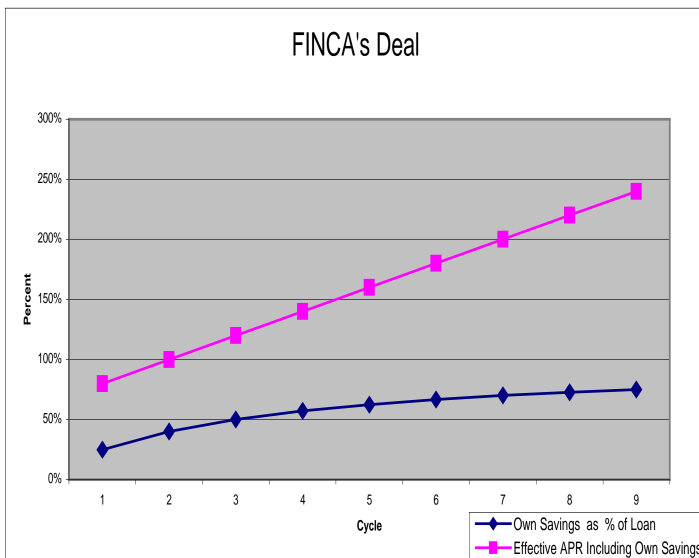
[5] Annualised Percentage Rate

1980s, in which groups would, after the **9th cycle**, graduate to establish their own independent Village Banks capitalised by their own compulsory savings accounts.

<u>The FINCA Model In Latin America</u>
From MkNelly and Stack, 1998

Freedom From Hunger reviewed their FINCA-based models in Honduras and Bolivia in the light of the "stagnation" of the size of loans taken by the villages banks. They noted;

- On average only three (21%) of the Honduran borrowers and four (15%) of the Bolivian borrowers who joined in a village bank the first cycle were still taking loans in the eighth cycle.
- While savings increased, the clients preferred to take loans from the internal account as these were more flexible in use (could be used for consumption/emergency needs), repayment terms (the clients could avoid the stress of weekly repayments, which they feared) and the effective interest rate was lower (even though the nominal rate was higher).
- They concluded, "Particularly, as graduation of village banks is no longer a goal, the focus must be on extending good-quality, self-sustaining financial services that maximise programme benefits and positive impact.



A Small Explanation
(In Case You Wondering About The APR Interest Rate Calculations)

Cycle	Weekly Repayment Size	Weekly Interest Payable	Annualised Interest Payable	Repayment Over Av. Base Loan
1	13,654	1,154	60,000	80%
2	17,067	1,442	75,000	100%
3	20,481	1,731	90,000	120%
4	23,894	2,019	105,000	140%
5	27,308	2,308	120,000	160%
6	30,721	2,596	135,000	180%
7	34,135	2,885	150,000	200%
8	37,548	3,173	165,000	220%
9	40,962	3,462	180,000	240%

Average Base Loan Outstanding over the 16 weeks = Ush. 75,000 as the loan is repaid on a weekly basis.

In Uganda, the original FINCA "model/system" has scarcely been changed[6], and little provision has been made to allow loans larger than the Ush. 600,000 maximum, with the result that members are effectively borrowing their own money back again at increasingly high interest rates. This was a little surprising in that the idea of graduating village banks to stand alone and independent was dropped by "Village Banking" acolytes several years ago[7]. The result is that many FINCA clients

[6] Although this is apparently in process in Uganda and well underway in Tanzania.
[7] "At the International Village Banking meeting in 1994, the concept of graduation was discussed by managers and proponents of village banking from all over the world. The failure to have banks actually graduate from their programs as a phenomenon witnessed by many programs ... At this meeting, it was decided that the word "graduation" in reference to village banking should be abandoned. Instead, there was an emphasis on establishing ties to as many formal financial institutions as possible." - **World Bank**, "CARE Village Banks Project - Guatemala", *Sustainable Banking With The Poor, World Bank*, Washington, 1997.

who reach their 9th cycle withdraw all their savings (to invest in the business or in some cases to buy land) and start again with base loans – a response that is economically rational. Several clients chose to drop-out completely after the 9th loan cycle.

Many clients are also using these high levels of locked-in **compulsory savings as a disciplined savings** system to build-up lump sums for major acquisitions, typically of land or for house-building. Once the target has been achieved, the clients plan to drop-out and leave the MFI. By way of example, one client noted that his ambition in joining Faulu is to save up a total of Ush. 3 million: 1 million for a plot of land, 1.5 million for a house, 500,000 for working capital. Although his primary motivation is saving, he says the loans are also very important, since careful use of them can enhance his capacity to save. This is a strategy the ***MicroSave*** team has also seen in previous work on Uganda Women's Finance Trust (UWFT).

However, several clients complained that the MFIs' systems and sometimes even their credit officers prevented them from **accessing their voluntary savings** in times of emergency, and this has on occasions been the basis for clients to drop-out. The systems requiring multiple signatories, together with the extended systems of guarantee that now often involve all the larger groups' savings[8], mean that clients are prohibited from withdrawing just when they need their voluntary savings most. As a consequence many are setting up alternative mechanisms outside the MFIs' systems in which to store their savings. These systems range from accounts in formal sector, commercial banks to Accumulating Savings and Credit Associations within the groups. At the other end of this continuum is PRIDE's policy of giving a 10% on average savings balance per annum bonus to clients on their compulsory savings/loan insurance fund when they are leaving the organisation. This is an admirable attempt to compensate clients for their locked in savings, but results in an incentive to drop-out and join again in order to get access to voluntary savings and handy bonus … something that many PRIDE clients are doing[9].

Not-so-Poor Drop-outs

The not-so-poor drop-outs seem to leave or be forced out as the loan and thus **weekly repayment size** mounts. One member the research team talked to dropped-out since she could not service her Ush. 1 million loan – but "I wanted to leave with a good relationship so I could rejoin the group if I wanted in the future". Another noted, "Faulu was very good for me early on … but to repay Ush. 65,000 every week is a big problem". Officers in almost all the institutions the research team visited noted that by the 3rd and 4th cycles, many clients began experiencing problems meeting the weekly repayments. Several groups have responded by setting up Accumulating Savings and Credit Associations amongst themselves to pool funds and advance credit to those struggling in any given week. A quick analysis of the progressive loan sizes of FOCCAS endorses the concern expressed by one of their credit officers that by the 3rd and 4th loan cycles, clients were often struggling to make the weekly repayments. FOCCAS loans increase by a maximum of 50% with every cycle[10], so that by the 4th cycle, 11 months after joining the programme, clients are often paying Ush. 11,715 a week – nearly three and a half times the weekly instalment they paid for their first loan.

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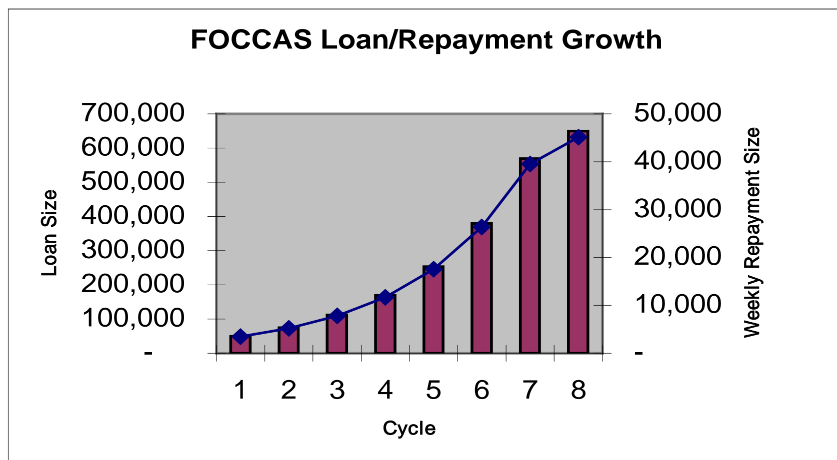
[8] Although, theoretically this guarantee should extend only to compulsory savings, the research team came across several instances of over-zealous credit officers blocking access to voluntary savings as well in order to protect the quality of their loan portfolio.

[9] This is a phenomenon that Grameen Bank and its many MFIs following its model have faced. Locking savings in until clients leave the organisation is a very powerful way of encouraging them to drop-out periodically – see Appendix 3.

[10] FOCCAS management note that typically the clients only increase their loans by 30% per cycle after the first two loan cycles.

Just over two years into the programme, by the 8th cycle (if any remain) they would have theoretically reached the maximum loan size set by FOCCAS, Ush.650,000 and be paying Ush. 45,125 a week – only marginally less than their 1st cycle loan[11].

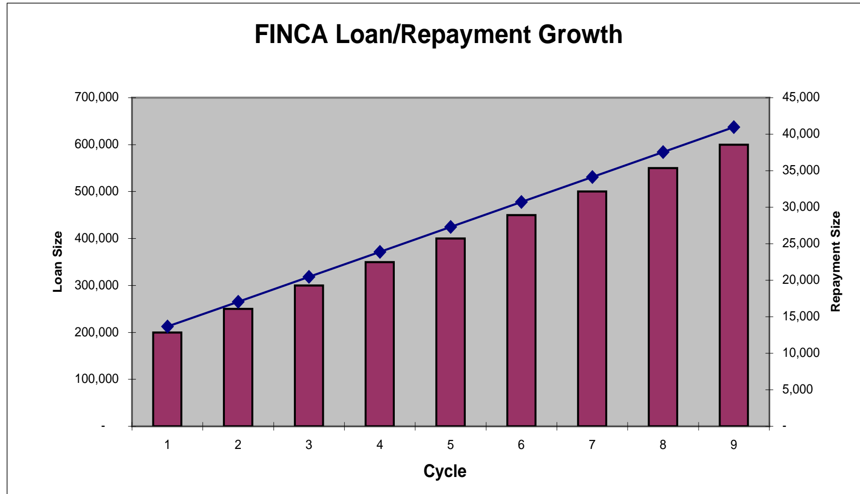


FOCCASing on the Figures

Cycle	Loan Size	Weekly Installment	Year
1	50,000	3,471	0-Jan-00
2	75,000	5,207	21-Apr-00
3	112,500	7,810	11-Aug-00
4	168,750	11,715	1-Dec-00
5	253,125	17,573	23-Mar-01
6	379,688	26,359	13-Jul-01
7	569,531	39,539	2-Nov-01
8	650,000	45,125	22-Feb-02

[11] FOCCAS is now experimenting with 20 and 24 week loan cycles in order to address this problem.

Although the FINCA model has been the inspiration for the FOCCAS system, because loans are confined to "Base Loan" plus compulsory savings, it does not face the clients with the same steep increase in the weekly repayments required. However, of course, clients can be servicing loans from the "internal account" at the same time as their formal FINCA loans, and this could well result in substantial stress.

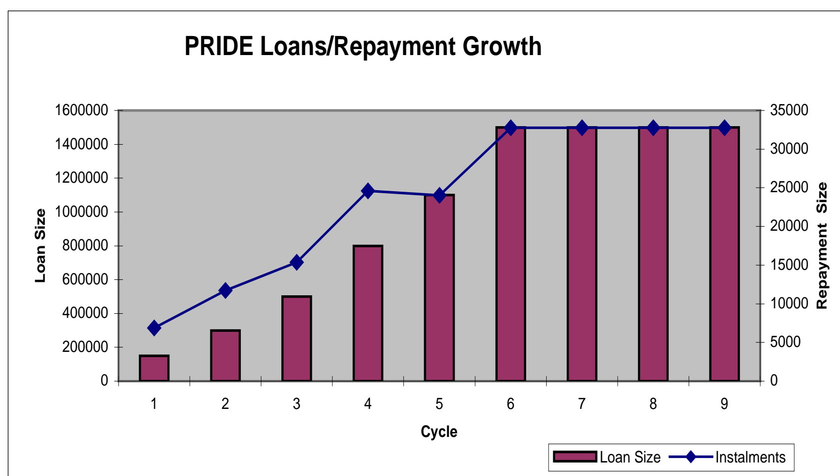


FINCA Figures (ii)

Cycle	Loan Size	Weekly Installments	Year
1	200,000	13,654	0-Jan-00
2	250,000	17,067	21-Apr-00
3	300,000	20,481	11-Aug-00
4	350,000	23,894	1-Dec-00
5	400,000	27,308	23-Mar-01
6	450,000	30,721	13-Jul-01
7	500,000	34,135	2-Nov-01
8	550,000	37,548	22-Feb-02
9	600,000	40,962	14-Jun-02

This graph is prepared on the basis of a Ush. 150,000 "Base Loan", although in many rural areas, FINCA starts with a Ush. 50,000 "Base Loan" – an amount viewed as "too small" by many clients.

PRIDE address this with a more flexible system that allows the clients to chose the size of their loan subject to increasing stepped maximums per cycle and having 25% of the loan size in their compulsory savings/loan insurance fund account. PRIDE's system also allows clients longer periods to repay larger loans. The first loan (maximum Ush. 150,000) is repayable over 25 weeks, loans above Ush. 300,000 are repayable over 30 weeks, above Ush. 500,000 over 40 weeks and over 1,100,000 over 50 weeks. This flexibility keeps the repayment instalments down to a more manageable size. Similarly, the PRIDE system requires clients to deposit Ush. 2,200 in the compulsory savings/Loan Insurance Fund (LIF) account, irrespective of loan size. This means that the LIF grows relatively slowly and even if the client is saving and borrowing the maximum amounts, the LIF takes around 7 years until it grows to be 50% of the loan size available[12]. 3

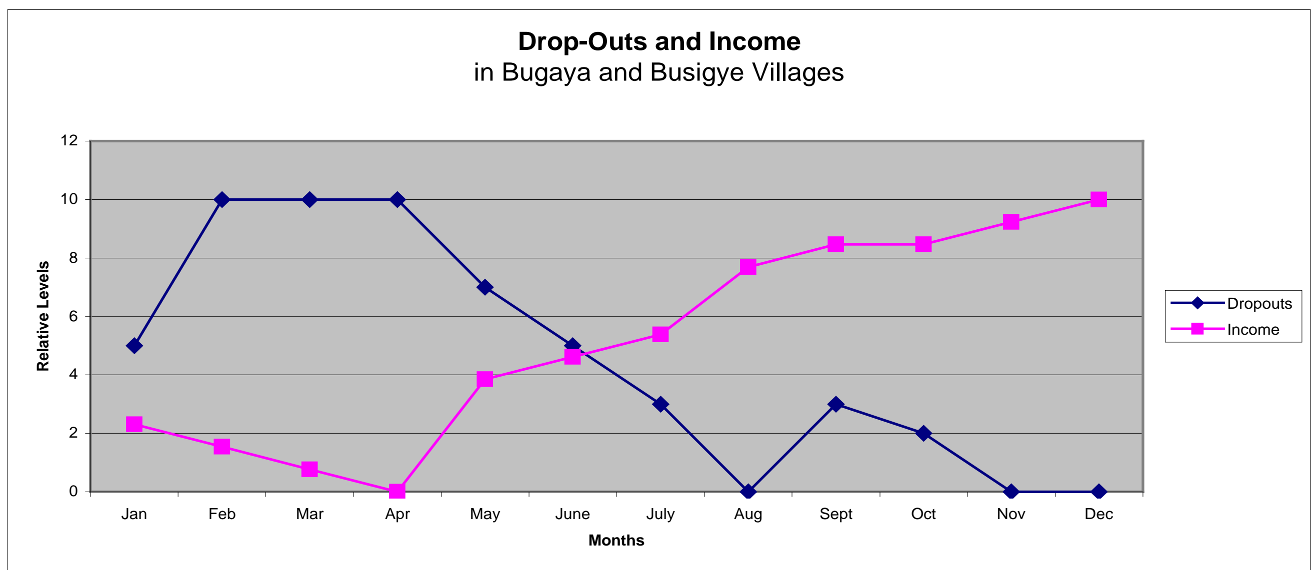


[12] However PRIDE is considering raising the LIF weekly payment on the basis that they seem to be running into problems when clients with larger loans default, and the LIF is not sufficient to cover the loss.

PRIDE In Numbers

Cycle	Loan Size	Weekly Installments	Compulsory Savings LIF	Year
1	150,000	6,865	37,500	0-Jan-00
2	300,000	11,731	92,500	23-Jun-00
3	500,000	15,385	158,500	19-Jan-01
4	800,000	24,615	246,500	26-Oct-01
5	1,100,000	24,031	334,500	2-Aug-02
6	1,500,000	32,769	444,500	18-Jul-03
7	1,500,000	32,769	554,500	2-Jul-04
8	1,500,000	32,769	664,500	17-Jun-05
9	1,500,000	32,769	774,500	2-Jun-06

In addition, in the rural setting people are more vulnerable to **seasonal variations** in income/expenditure flows and have fewer opportunities for making money than the urban settings where there are more opportunities to diversify (see Appendix 4). The research team believes that it is these seasonal variations, together with the rising loan sizes and most MFIs' rigid loan disbursement systems, that require clients to take loans at a specific date or not at all, has lead to many clients opting out or "**resting**". This phenomenon is particularly common in the rural areas, and (in part at least) explains the remarkably high levels of drop-outs amongst MFIs in Uganda. Clients simply opt out of a cycle when it coincides with the low season, often leaving a balance in their savings account as part of their commitment to taking another loan when the next cycle begins. The seasonality analysis of drop-outs conducted with two sets of rural clients in different villages clearly mirrored the rural seasonality of income. These seasonal "drop-outs" (who are usually simply resting) are less common in MFIs such as PRIDE, Faulu and Centenary who allow clients to just save for a while and give loans when they are requested and not on strict, season or need-blind, cycles.



Seasons and Drop-Outs
From Interviews in Bugaya and Busige Villages

January: Considered to be a fair month with few exits because borrowers (who are mainly traders) have savings from December sales and therefore able to service loan. Nonetheless, the pressure of school fees does increase pressure from the expenditure side.
February- April: A tough time during which a lot of people drop-out or rest because business becomes slow. The general local economy, which is driven by agricultural seasons, is sluggish and there is little demand for anything. People live hand to mouth and so most business people suffer low sales. Even those selling food make less profits because people reduce the volume of food they consume. What makes these months particularly difficult is the dry month of January which often ruins many people's crops and thus forcing them to buy food and leaving them with no surplus for non-basic items like clothing. This means that constrained household cashflows cannot meet the required debt service, so many people plan to rest during this period. The drop-outs around this time leave with a debt forcing the guarantors to take care of it. During this time people are unable to make serious savings which negatively affects the loan sizes they get during next cycle.
May to January: People starting harvesting coffee, maize and a lot of income flows into the local economy resulting in increased sales for most businesses. Drop-outs are much rarer once this season has started.

The ***MicroSave*** study of UWFT's clients indicated that very often, the more successful ones are those with more diversified income sources, and particularly households with at least one salaried employee. This allows the household to better manage the weekly repayments throughout the year.

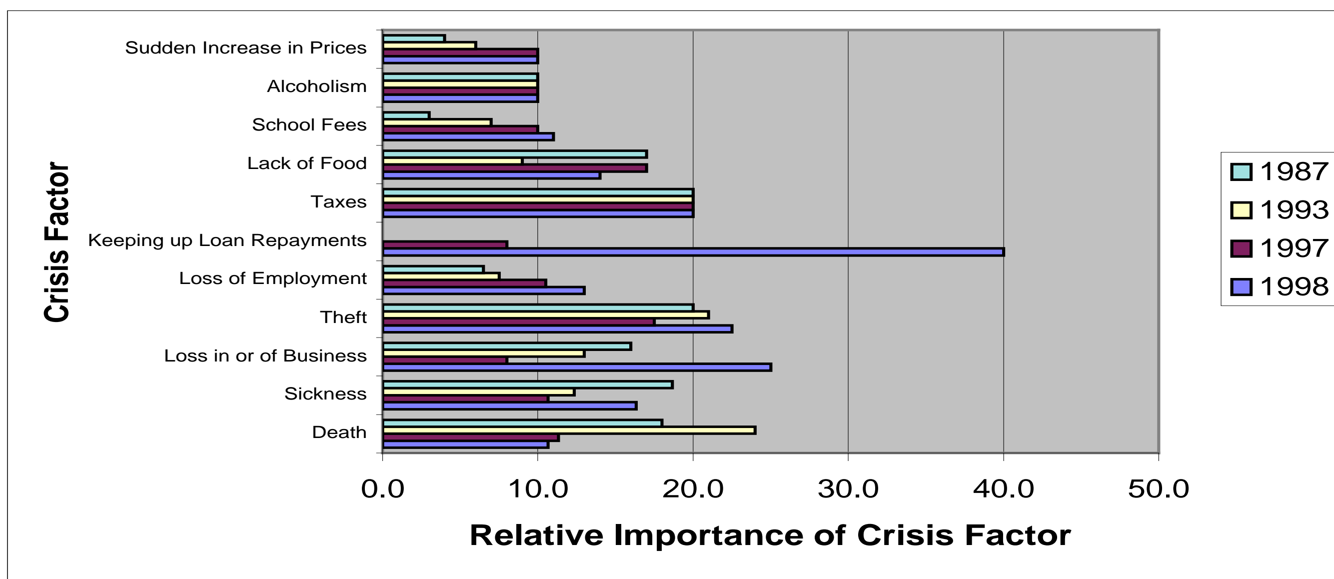
UWFT Clients' Diversified Income Sources
from
Graham A.N. Wright, Deborah Kasente, Germina Ssemogerere and Leonard Mutesasira, 1999

"Many of households interviewed have diversified economic portfolios that include various types of enterprises, rental income and salaried income. In some cases the client is managing a range of very different activities, each contributing to the goals of the household in different ways. They tend to be differentiated in terms of their demand on the household members' time and management capability. Loans from UWFT are sometimes distributed between the various economic activities. As one UWFT member said, "Apart from the business I do in the shop, my husband also lends money to *matooke* traders who pay him back with interest. I also have another source of income, I sell food in the evening market when I go back home."

A lot of combinations of activities reflect a mix based on regularity of income flows. Some businesses such as sale of charcoal, beer, popcorn and water are important sources of regular, and often daily, income. One example is a woman who on top of charcoal (for daily cash flow and weekly loan repayment) rears poultry – which involves selling a large batch of chickens for Christmas and Easter time, thus generating useful lump sums at these times."

The **pressure** associated with coming up with the money to make weekly repayments also featured prominently in the UWFT study. One of chief problems faced by the research team was the premium placed on time by clients, a factor that made them sometimes unwilling to participate in the research. Clients were acutely aware that time was money and that time not spent on their business was earnings lost … and that UWFT's repayment schedule meant that they had to have the

weekly instalment ready at the next meeting. In the words of one member, "Since I took the loan, I have learnt to work hard all the time", and of another, "When you know you have to pay back on the day of the group meeting, which is once a week, you cannot just buy anything or waste time". This issue was highlighted time and again during the research team's time-series analysis of crises affecting UWFT clients. When reviewing the graph of the "Relative Crisis Factors", it is instructive to note that in 1987 and 1993, the clients had not joined UWFT, and that by 1998 (on average) their loan sizes (and therefore weekly repayment instalments) were significantly larger than in 1997.



Poor Drop-outs

Poorer drop-outs leave or are pushed out from MFIs primarily because they find **problems repaying their loans**. It is reasonable to speculate that they have fewer, less diversified sources of income with which to manage the weekly repayments. The research team's work suggests that the poor were the ones most commonly pushed out by fellow group members or the MFI, usually on the basis that they were struggling to meet their repayments, and occasionally on the basis that they had poor attendance at meetings. There does seem to be a common practice of culling the poorer, weak repayers in the early cycles amongst all the MFIs, although this practice is particularly marked with PRIDE, it is common throughout the MFIs the research team examined. In the words of one PRIDE Branch Manager, "The second[13] biggest exodus happens between the 1st and 2nd loan cycles which we look at as testing loans. This is when those with a culture of non-payment are discovered and flushed out by fellow members of the Enterprise Group[14]". This attitude was reflected by another PRIDE manager, "Exits are like weeding – if you don't weed, you don't get a good crop". Clients too noticed this, "FINCA does not harass you in the way that PRIDE does. At PRIDE you get pressed for weekly payments and you can get pushed out very quickly if you don't make them".

[13] After seasonal economic depression, since this manager heads a rural branch.
[14] PRIDE's small groups of 5.

Group Guarantee Behind Closed Doors

At the end of the meeting the research team watched the process of one group being pressured to complete payment. They were told that they should not leave the meeting until the money was paid. There was heated discussion among them, with members telling each other to contribute, and denying that they themselves had the money with which to contribute. There was Ush. 8,000 missing. Finally a man from another five person group provided the missing money. He told the team that he would probably get the money back from the defaulter (who was not present) and that the defaulter would "probably buy him a soda".

Technically the PRIDE credit officers do not have the right to expel clients, but "the computer exits clients that miss more than three consecutive repayments". In practice it seems that the strict discipline of the system that forces clients to stay in the meeting hall until the loan has been finally repaid and attaches others' savings also drives groups to **push-out members** who struggle to meet their weekly obligations. The research team also found one instance where one MFI had started operations in a poor area, issued loans, experienced quite widespread problems with loan repayment and decided to withdraw the programme in its entirety. This resulted in many people's savings being attached to repay the outstanding loans of others, and the MFI left behind a fair degree of chaos and bad feeling.

In addition, the poor are more prone to **illness** and **death** in their (perhaps larger) families, two other strikingly common causes of drop-out. Often drop-outs on the basis of these problems seem to temporary and when the client has recovered from or responded to the crisis, she returns.

Other Issues not Specific to Socio-Economic Groups

A very common theme was the dislike of the system of **attaching savings**, particularly since this has now been almost universally extended to include not just the sub groups of (typically) five but also the larger groups by some MFIs operating in Uganda[15]. This has broadened the group guarantee from a small number of people who (if the group has "self-selected" properly) know each other well, to a larger group who do not. As one group member said to us, "Why should I guarantee the loans of people I scarcely even know, and whose businesses I have never seen ?". Others suggested that the MFIs should seek and attach collateral from defaulters rather than "penalising people who didn't eat the money".

As ***MicroSave*** researchers also noted in their review of UWFT, this also results in clients under-utilising what limited voluntary savings services are provided by MFIs in Uganda. One ex-client noted that savings can also be in part voluntary which was "a good thing" but they are at risk if other group members default, and therefore "we fear to put too much savings. This was a main reason why I left - there were too many top ups[16]". This can also lead to **groups "unzipping[17]"**

[15] The exception, of course, being Centenary Rural Development Bank which lends on an individual physical collateral basis.

[16] The practice of deducting from savings to make up for missed loan repayments

[17] The "unzipping" effect (a term first used by Rutherford in 1992) is when the guarantee group, and indeed often the entire larger group, burdened by excessive or multiple default, sees no further hope for continuing loans and elects to default *en masse*, thus causing the group (and the group guarantee that held it together) to "unzip". It is this risk that drives MFI field workers to continue to give loans to the good payers in the longer established groups - after all they have developed a long credit history - and thus to negate the group guarantee principle. And it is for this reason that,

and the loss of many good quality clients. For example, one PRIDE credit officer noted, "One 5 person cell was dropped in its entirety four months back, because three of the members "deliberately" defaulted, and then disappeared from their work places. The other two were paying OK but their savings were not large enough to cover the full default of the three bad payers: therefore they had all their savings confiscated and decided to leave".

Another complaint amongst clients was with the way that some **credit officers made decisions**. In several of the MFIs studied credit officers have been given latitude to assess the clients' capabilities to service loans and take decisions on the size of the loan to be issued. This has caused some dissatisfaction and drop-out, particularly in the context of issues surrounding clients' perceptions that they are paying to borrow their own savings. One female drop-out the research team spoke to had savings of Ush. 1 million and wanted to borrow Ush. 1.5 million. The credit officer would only sanction Ush. 0.8 million. Another member of the same group had had savings of 0.8 million and got a loan of 1.3 million and in the words of the aggrieved client, "I could not understand why – it didn't seem fair". Another noted, "The new credit officer was very conservative and would only lend the value of your savings. You were borrowing your own savings and they [the MFI] were charging interest. I asked myself what am I doing here ?" The practice of loan size at the discretion of the credit officer is also disliked on the basis that the client cannot plan since she does not know how large a loan she will receive.

In addition, in almost all the MFIs reviewed there is a tendency of **credit officers to refer all problems back to the group**, leaving the onus on the group and its leadership to resolve them. This has caused high levels of dissatisfaction, particularly in view of the fact that often the problems arise from enquiries about disparities in book-keeping, attached savings or delayed disbursement of loans.

It is interesting to note that despite the concerns expressed by many practitioners, there seems little evidence for large numbers of people joining MFIs on a **speculative basis** to see whether they could get away without repaying the loans. While there were isolated reports of this, it was not a wide-spread recurring issue[18]. Had this been an important issue, the symptom would have been large scale drop-out after the first loan cycle, often without full repayment of the debt. The research team saw few instances of this, but as noted above did see many people struggling with the weekly repayment regime and as a consequence being eased out of the groups. Most of the (many) drop-outs during the 1st and 2nd cycles seem to have been testing or reviewing the MFIs' systems, not with the intention not to repay, but rather to see if it suited them and their household economy. On discovering that they struggled with the regularity and discipline of making repayments, they chose to withdraw, or were forced to by their fellow group members.

There is limited evidence to suggest that there are any significant differences in the **gender of drop-outs**. However, this may be difficult to disentangle since different MFIs have different policies on this: FINCA and FOCCAS work almost exclusively with women, PRIDE, Faulu and Centenary Bank welcome both men and women. Some credit officers suggested that women drop-out more since "women don't care much about it [repaying loans] – they have their husbands",

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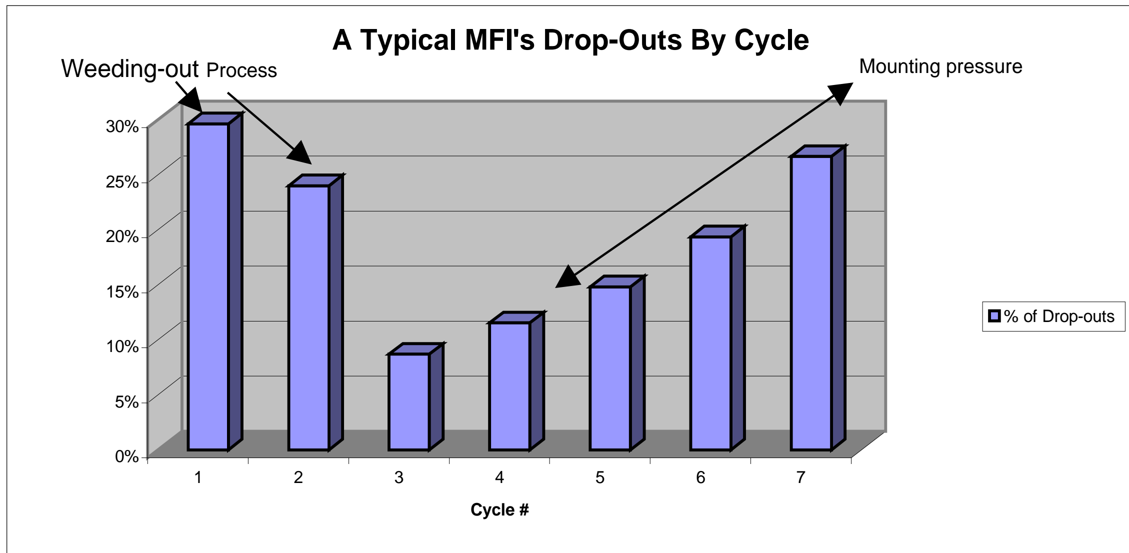
despite all the rhetoric, the effectiveness of the group guarantee principle is limited to the first few loan cycles.

[18] The only place where the team found this as a problem was in Tororo, where the Co-operative Bank's microcredit programme was viewed as a political programme (like Entandikwa) being routed through the bank.

while others suggested that there are more male drop-outs since "they are stubborn and think they can get away with it [not repaying loans]". The other important gender issue was the problems wives faced with their husbands either objecting to them travelling far to attend weekly meetings (thus reducing the time they allocate to the house and fields) or taking loan money without helping with the weekly repayments. These were relatively isolated cases, but are nonetheless important to consider, particularly in the rural environment where the problems seemed to be more acute.

In Summary
In summary the research team hypothesise that the typical amalgamated pattern of the MFIs which it reviewed the pattern of drop-outs can be summarised as follows:



In this diagram the drop-outs in the first two cycles arise primarily from those clients who are finding out whether they can manage the weekly repayment regime and MFIs with aggressive "weeding out" policies. The rise in the number of drop-outs in the latter cycles arises primarily from clients facing problems with the rising weekly repayments, tiring of weekly meetings and frustration with "borrowing their own savings back".

WHO DOES NOT JOIN AND WHY?

The pattern of who does not join MicroFinance Institutions dovetails neatly with the reasons people expressed for dropping out.

The rich are said not to join since the loan amounts made available are too small to be worth all the effort. In addition, the weekly meetings are viewed as being too time consuming and onerous for "busy mobile businessmen [sic]".

The not-so-poor find the services useful because they have small businesses that are short of capital and they sometimes have domestic problems and need money to deal with these. These are therefore the main participants in the schemes. For a description of how the not-so-poor view and describe themselves, see Appendix 5. It should however be noted that the not-so-poor remain vulnerable. Critiques of microfinance based on "not reaching the poorest" tend to overlook the dynamic nature of poverty discussed in detail in Wright et al., *forthcoming*. Not-so-poor households hit by a severe crisis (fire in houses and business, theft of business assets and chronic illness including HIV/AIDS were common amongst respondents) may be transformed into "poorest" households with alarming rapidity. This is why microfinance's role in assisting with the development and maintenance of robust household economic portfolios is so important … for anyone and everyone who does not have access to financial services from formal sector.

There are relatively few of **the poor** in the groups for a variety of reasons that span exclusion by the MFIs' staff to self-exclusion by the poor themselves.

Exclusion by MFIs' Staff
Many of the poor the research team talked to in the poorer Kampala slums had simply not heard of any of the MFIs. This is probably since the MFIs' credit officers do not approach them. There are two possible (and not mutually exclusive) reasons for this: firstly, the poor are often "invisible" and unknown to the MFIs and their staff because of their appearance and where they live and go to work, and secondly the MFIs do not view the poor as good clients. Indeed the MFIs in Uganda (in common with many throughout the world) have clear policies that exclude the very poor by requiring that members have an on-going, fixed-site business. In addition, the prospective clients must save regularly (typically for at least six weeks) and build up a compulsory savings/LIF of 25-35% of the loan required. This requirement automatically screens out many poorer potential members. One poor lady (who stays in a single room with her young brother, a casual labourer) noted that she knew about PRIDE, but she also knew that she cannot join because she does not have a permanent job to enable her save and thus get a loan.

Exclusion by Group Members
With the extension of the group guarantee to include the larger groups, existing members have in some cases made these strictures even stronger, excluding (for example) hawkers (on the basis that they have no fixed business) or taxi drivers (on the basis that they move around)[19]. The poor do not join MFIs' groups because they fear getting in trouble with loans and having to liquidate their assets. Thus even those poor who want to join cannot do so because they cannot find anyone to guarantee them since everybody knows they are very high risk. Similarly Wright et al., *forthcoming*, noted "However, women who are considered risky, like widows, poor women, and women whose lives are in crisis, are not usually invited by the other women to join UWFT groups – probably in view of the group guarantee mechanism".

Self-Exclusion
The poor also self-exclude for the same reasons that those who <u>do</u> manage to get in often drop-out again. In particular, the stress associated with membership: both in terms of having to find the weekly instalments and in terms of the regular meetings are strong disincentives to join. As an older woman who has not joined PRIDE, told her friends who were encouraging her to join, "I'm

[19] Although some MFI staff noted that they felt that "boda boda" motorcycle-taxi drivers were good clients, especially since they had regular daily income.

too old - I don't have the energy. You have to work too hard if you take loans like that". Another lady says that her husband has 6 acres of land so she spends a lot of time digging, she cannot have the time to attend meetings because no body will be there to attend to her gardens. " My husband cannot pay labourers to work in our gardens when I'm there [at the weekly meetings]".

In addition, amongst the poor and particularly the very poor, there is a perception that they are likely to lose the few assets they have through the group guarantee system, or in extreme cases "be arrested from the house and sent to jail" for failure to repay the loan.

There is, it should be noted, an underlying theme amongst all the reasons for drop-out – that of the nature of the systems and products on offer by the MFIs. The way the financial services are designed and delivered leads to the exclusion of the poorer households in the community – either they, or their peers cannot take the risk of joining such rigid systems. And for the better-off, it is simply not worth the hassle[20].

WHO HAS MULTIPLE MEMBERSHIP AND WHY?

While the research team found relatively few clients with multiple membership of MFIs, they found many with multiple membership of financial service organisations, particularly in response to the need to find effective and responsive savings mechanisms (see the "Use and Impact of Savings Services in Uganda" study report). Where clients had multiple membership of credit-giving MFIs, they were almost invariably the better-off and have joined two organisations in order to "patch" loans together to create loans large enough to make business investments.

The other motivation for taking out multiple membership seems to have been to get access to small regular loans in preference to large one-off loans. The research team initially assumed that this was to reduce the inevitable run-down of working capital/stocks that accompanies repayment of a full loan before accessing the next, but this phenomenon also seems to be associated with matching the timing of loans to specific needs.

Clients with multiple membership complained that the length of MFIs' meetings meant that they lost too much precious time and were away from their businesses too long. Indeed, they talked of some clients who had taken out membership in three MFIs in order to access larger loans and had lost their businesses to interminable meetings. As this last example illustrates, multiple membership has high cost. Multiple membership necessitates complying with multiple sets of rules and sitting in multiple weekly meetings, taking precious time away from pressing business and household activities. In addition, several of the MFIs have membership and loan application fees. In short, multiple membership is not something to be entered into lightly - it costs time and money. Few clients will voluntarily take out multiple membership unless they are not getting all the services they need from a single organisation. In the same way that much drop-out is indicative of dissatisfaction with the financial services being offered, multiple membership also suggests that the client is looking for something more. One of the most common complaints about the services on

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[20] Which, of course, can be seen as a rather useful screening mechanism for programmes looking to work exclusively with poor people. Nonetheless, some relatively well-off households, with the potential to be excellent, high value clients, which are important for institutional sustainability, remain without access to the formal sector banks and vulnerable to shocks and crises.

offer from MFIs is that the loan ceilings are too low for many clients' businesses. So these potentially good and lucrative clients are compelled to take out multiple membership in order to access two or more loans to make up the amount they feel they need. They then not only have to handle two (or more) sets of rules and meetings, but also the varying loan disbursement schedules. Once again clients find themselves forced to manage their way round inflexible systems.

It is for this reason that when an MFI offers quality financial services that respond to the needs of its clients, they are much less likely to take out multiple membership. Indeed, there is evidence from Bangladesh that they are likely to be willing to pay a premium for the convenience of having all their needs met by one institution, in one meeting. Of course, the problem will be to correctly identify those clients who really can manage larger loans.

DISCUSSION/RECOMMENDATIONS

Amongst MFIs operating in Uganda there appears to be a culture of assuming that the clients are going (possibly even want) to default. This may or may not be valid, but it remains a powerful and pervasive (if not always explicit), influence on the design of MFI systems and products in the country. As a result, the MFIs prefer "**sticks over carrots**" as a method to encourage repayment. Clients are required to deposit remarkably high levels of compulsory, locked-in savings and loan insurance funds, the group guarantee system is implemented with ferocious zeal and groups are instructed to sort out all their own problems for themselves.

Uganda's recent history has been turbulent, the microfinance industry here is still in its infancy, and there has been a tendency to use credit for political purposes. Perhaps in view of these factors, these draconian, stick-driven approaches are necessary in order to establish a good "**credit culture**" and reduce the number of speculative borrowers seeking a "grant-loan" (or "groan"). On the other hand, the research team saw on limited evidence of speculative ("groan"-seeking) borrowing[21], and a mass of evidence that MFIs' clients are becoming increasingly discerning and keen to seek out the MFI that provides the best possible services for their needs. In short, the competition between MFIs is growing.

In addition, there is growing evidence that despite the rhetoric surrounding "**group guarantee**", it is not proving as effective as its advocates suggest - particularly after the first two or three loan cycles have been completed. Amongst older groups, in the case of default, group guarantee is replaced by group fund guarantee and individual follow-up by the MFI's staff. On the other hand it has become increasingly clear that the single most effective deterrent for defaulters is the prospect of losing access to financial services - follow-on loans and (ideally) savings facilities. It follows, therefore, that the better the quality of the financial services provided, the more clients want to maintain their access to those services, and the less likely they are to default on loans. See Appendix 6 for a detailed discussion of these issues. Similarly, the better the quality of financial services provided, the less likely clients are to drop-out and go to the competition.

At present few of the systems and products on offer in Uganda can be described as client-friendly. They are expensive, conservative systems that are driven more by the needs of the organisation and a distrust of the clients than by a desire to offer client responsive products. With the growth of competition (at least in the more densely populated parts of Uganda) there is a pressing need for

[21] Although it should be noted that the team worked in areas where MFIs have been active for several years.

forward-looking MFIs to change if they wish to retain and grow with their clients. In the face of increased competition, MFIs will have to **design products that are responsive to their clients' needs**, and not just organisational dogma or systems – particularly not those that have been long-since proved to be ineffective and (in many cases) have been abandoned. There is evidence of this beginning to happen amongst several of the MFIs, thereby adding to the pressure on others to make the changes before it is too late. This stage of the development of the microfinance industry arose in parts of Bangladesh 5-7 years ago and one MFI, BURO, Tangail, responded promptly and developed a reputation as a market leader that pioneers products for the poor (see Appendix 7).

An additional complication is added by the fact that the MFIs in Uganda are serving a broad spectrum of clients, from relatively wealthy, urban clients to reasonably poor rural clients, and (in rhetoric at least) seek to serve the poor members of the community. This **diversity of clients** in turn necessitates a diversity of products. In the words of Hulme and Mosley (1997), "Our main finding is the need for the designers of financial services for poor people to recognise that "the poor" are not a homogeneous group with broadly similar needs. ... Recognising the heterogeneity of the poor clearly complicates matters for scheme designers ...".

On the basis of the evidence gathered by the research team, there is probably a case for using a relatively strict and disciplined group guarantee-based system in the first few cycles in order to screen out those that cannot or will not repay the loans. Thereafter, however, MFIs seeking to retain richer (high-value, high profit) clients will probably have to make a move towards **individual-based lending** (perhaps after a certain number of group-based loans during which the clients prove their credit-worthiness and discipline). MFIs seeking to retain not-so-poor clients will have to pay more attention to the seasonality issues that so profoundly affect their desire for credit and ability to repay (particularly in rural areas), rather than force loans on clients. Similarly, MFIs will have to examine options for offering **longer term loans** so that the weekly instalments remain small enough to be manageable from the clients' household budget[22]. For the not-so-poor and the poor, there is also likely to be a case for small **short-term emergency loans** in addition to saving services.

It is time to think seriously about offering **voluntary, open-access, unattached savings services** for which there is a huge demand (see also the "Use and Impact of Savings Services in Uganda" study). With the distinct seasonality of both income and expenditure flows in rural Uganda, there is a pressing need/demand for a savings mechanism to allow households to store money when they have excess income in order to meet loan repayments when they have too little income. Voluntary, open access savings services would also allow MFIs to serve the poorer clients currently unable to join and use the credit-driven services on offer. Given the paucity of low-risk savings mechanisms available in the informal sector or in the home, it can only be hoped that the Bank of Uganda will liberalise the restrictions on MFIs offering these services. This would allow the poor opportunities to save in the more formal settings offered by the better established MFIs.

Given the high levels of drop-outs resulting from illness/death in the family, it is also time to look at **insurance mechanisms**. Health insurance is notoriously difficult to provide to poor people on a

[22] In this context it is important to recognise that clients' weekly repayments often do not come from the business in which the loan has been invested. In addition, of course, clients often "divert" loans in part or in whole to more pressing needs and opportunities than those cited on the loan application form. Loan repayments are often simply managed out of the household budget, from selling some produce here or saving a few shillings there.

cost-recovery basis, although there are increasing numbers of institutions testing innovative approaches to this. However, life insurance systems are a great deal easier, and extremely popular with the poor[23].

Associated with transforming a traditional credit-giving MFI into a client service oriented financial service organisation is the challenge of **improving the quality of service** given by the credit officers. Persuading credit officers to see the group members as "clients" not "beneficiaries" is the first step. However the change from a stick- to carrot-driven approach also necessitates credit officers becoming savings and credit officers offering a client-friendly and responsive service not simply haranguing those in arrears or telling the group to sort it out for themselves. In addition, given the almost universal distaste for lengthy meetings, MFIs need to look at how meetings are conducted (contents and systems) and whether it is cost and time effective to try to teach the clients to maintain their own books of account.

All of the above requires careful **systems and product development**, a process that is not easy. The first steps are:

i) to get a better understanding of the market, the needs and opportunities of the clients (and potential clients) the MFIs are (or could be) serving; and

ii) to get a better understanding of the competition (in both the formal and informal sectors), its systems and products[24]

In addition to formal market research, the MFIs should use their own **institution-based information**. This includes financial information on existing client behaviour and more intensive research into clients' reasons for leaving as and when they do. In addition, there is a huge (and generally untapped) source of field-based information in the credit officers. As a result of their day-to-day interface with the clients, credit officers have a high level of understanding of the clients' needs, grievances and problems. As such credit officers should be seen as a tremendous source of high quality information. MFIs should consider setting up formalised systems for accessing this information – perhaps through periodic workshops with selected credit officers.

As the market for MicroFinance services expands in Uganda, the challenges and opportunities facing the MFIs committed to serving that market are growing. The high level of drop-outs amongst MFIs is symptomatic of a larger problem of inappropriate systems and product design, one that the MFIs who are serious about achieving sustainability must address.

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[23] However, it is important that the policy is clearly explained to the clients: several FINCA clients complained that although they had paid their (what are life insurance) premiums, when their business was in trouble, the insurance did not pay out. This misunderstanding had caused a great deal of disappointment.

[24] The research team was surprised to find remarkably little knowledge of one another's systems and products amongst MFI managers.

APPENDIX 1

METHODS USED

The research team used a variety of quantitative and qualitative methods to examine this complex issue.

Quantitative Methods

- The quantitative methods involved analysing the computerised drop-out records of MFIs participating in the study to look for trends, season variations, variations by cycle etc.
- In addition the team used Excel spreadsheets to model compulsory savings:loans ratios, repayment instalments, APR interest etc.

Qualitative Methods

- Key informant interviews were conducted with the managers and front-line staff of the participating MFIs.
- In-depth interviews were conducted with clients, drop-outs and non clients of the MFIs and in the catchment areas where the participating MFIs were operating.
- The team conducted extensive Focus Group Discussions with clients, drop-outs and non clients of the MFIs and in the catchment areas where the participating MFIs were operating.
- The team also used a variety of Participatory Rapid Appraisal techniques including:
  - ⇒ Seasonality calendars
  - ⇒ Wealth ranking
  - ⇒ Lifecycle-lump sum analysis
  - ⇒ Money management systems matrixes

A total of around 500 people were interviewed in about 75 different sessions.

APPENDIX 3
For Comparison: Drop-outs In Bangladesh

From Wright *forthcoming*

The increasing awareness of the importance of the number of drop-outs a programme experiences has prompted a series of studies in recent years in Bangladesh. In 1992, BRAC lost 102,814 (or 15.3%) of its membership, and another 78,725 (or 10.9%) of its membership the following year. Clearly, even when they are replaced, such client turnover may compromise the sustainability of a programme, particularly when the drop-outs were relatively long-standing members eligible for larger (and therefore for the MicroFinance institution seeking sustainability, more attractive and cost-effective) loans. Khan and Chowdhury (1995) collected information on the drop-outs' length of membership and concluded, "The average years for which they had been members before leaving was 4.7 for males and 3.8 years for females." This strongly suggests that BRAC was indeed losing many of its older, more experienced, and cost-effective clients, and that only a part of the drop-outs arose from villagers joining on a test basis before concluding that BRAC's system was not meeting their needs or expectations.

It should, however, be noted that in these two years BRAC was undertaking a membership restructuring exercise. As Khan and Chowdhury (1995) stress "In order to extend services to larger number of households, only one member from one household was allowed to retain VO membership. In RDP's emphasis on women, the male members were asked to vacate their membership, which also resulted in disproportionately high dropout among male membership as reported in this study." This is, nonetheless, in marked contrast to the same study's observation that "Over three quarters of the respondents from among the discontinuing category reported that they voluntarily dropped out while a quarter was expelled. The proportion of those expelled was higher among males, while the proportion of those dropped out voluntarily was larger among the female members" Khan and Chowdhury (1995). We can therefore probably conclude that only a small proportion of the drop-outs arose as a result of the membership restructuring underway. More fundamental issues were driving members to drop-out of BRAC's programme.

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. Sixteen reasons for drop-out were catalogued by Hassan and Shahid (1995). Of these, four related to social pressure (peer pressure over loan repayments, family disapproval/problems etc.), four to resource constraints (inability to finance weekly loan repayments, group fund not refunded, savings not available for withdrawal in emergency etc.), and four to the organisation (BRAC) itself (unpaid loan instalments resulting in the expulsion of the client, low interest on savings, member unable to count and sign her name and cancellation of membership while away). The remaining four were migration, death, joining another NGO and no access (as hoped) to Vulnerable Group Development cards.

Mustafa et al. (1996) noted in particular causes related to lack of easy access to savings, the excessive emphasis on credit discipline, the frequent policy changes and conflict among Village Organisation members. ASA's (1996) study noted "negligence of the staff/lack of staff quality and efficiency" which was identified in 56 (27.72%) of cases, low loan ceiling and "absence of multiple credit" identified in 151 (74.75%) of cases, and an additional 47 (23.27%) "members withdrew their membership as they disliked the savings rules".

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			
Failure to repay loan	44.8	56.1	59.6
Irregular attendance in meeting	17.2	41.5	27.3

These high levels of drop-out prompted Hulme and Mosley (1997) to conclude, "Given the scale of "dropping out" (15 per cent per annum for the Grameen Bank, which is 300,000 members a year; 10-15 per cent per annum for BRAC, or 181,700 members, in 1992 and 1993) there may well have been significant under reporting of credit-induced crisis in most studies of finance for the poor". But although this may well be important for a minority, examination of the studies 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[25]. 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 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, 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 need of the client

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

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, 1995a). 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 MicroFinance Institutions (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.

Clients "shopping around" for the best services (or at least ones that meet their needs) has also lead to prevalent "multiple membership" of the same clients with different MFIs. In the Districts such as Manikganj and Tangail where many MFIs and NGOs are operating, villagers may be members of several organisations. Indeed, some estimates suggest that 40-50% of people in these Districts have multiple membership, and certainly PromPT's (1996) study found it a common phenomenon. Many MFIs and NGOs have reacted negatively to clients taking services from several organisations by trying to prohibit multiple membership. The reasons for this vary, it depends on who you talk to. The common official explanation is the fear that clients will take several loans from various organisations, use one loan to pay off another loan, and "over-stretch" their ability to repay. The less common, unofficial explanation is the MFIs' desire to maintain a monopoly over providing financial services to their clients, and a fear of competition.

But this all requires careful thought. In affluent societies, and indeed among the richer classes in Bangladesh, having several accounts is common (meeting a variety of savings and credit needs - current and fixed deposit accounts, housing or building society accounts, shares, hire-purchase accounts for appliances, a mortgage, credit cards and so on). This occurs because these different accounts or financial services meet different needs, and there are only limited additional costs associated with having multiple accounts and membership with these financial service organisations.

Of course, in some individual cases the MFI managers are right to worry about "over-stretching" of clients' ability to repay, and over-ambitious clients. Indeed Matin (1998a and 1998b) found many households deeply in debt to local money-lenders (another form of multiple participation in credit markets) in order to maintain their weekly repayments to MFIs through the lean season and other periods of stress and cash shortage. Matin (1998a) notes, "Some degree of cross financing is inevitable because of seasonal fluctuations in income and when coping with shocks (Wiig, 1997). But it can have a deleterious effect in the long run if households continuously manage loan repayment without having the ability to repay." Those interested in promoting open-access savings facilities would note that such facilities would provide a much better, cost-effective method for households to meet these short-falls and maintain the weekly repayment discipline.

In 1992-93, under pressure to respond to rising wage costs and achieve increased sustainability, Grameen Bank suddenly introduced seasonal loans on top of the traditional general loans, thereby doubling of the value of loans to (or debt burden of) its members. Matin (1998b) examined the effects of this move, and found that the "non-defaulting group have significantly lower multiple credit NGO participation, lower loan burden measured in terms of: a) proportion of borrowers having loans in addition to general and seasonal [loans], b) total outstanding due as a proportion of income and c) total instalment size." As noted above, there is some indication that these loans were being forced on members both from studies conducted (PromPT, 1996) and from internal correspondence within Grameen. For instance in 1993, a Grameen Bank branch manager in one of his monthly reports to the Managing Director wrote (quoted in Rahman, forthcoming): "Recently there is an intense competition among different managers to increase their loan disbursement. Increasing disbursement is important for the bank, but we must not forget the capabilities of our members. If we continue with our present attitudes, the result will be serious."

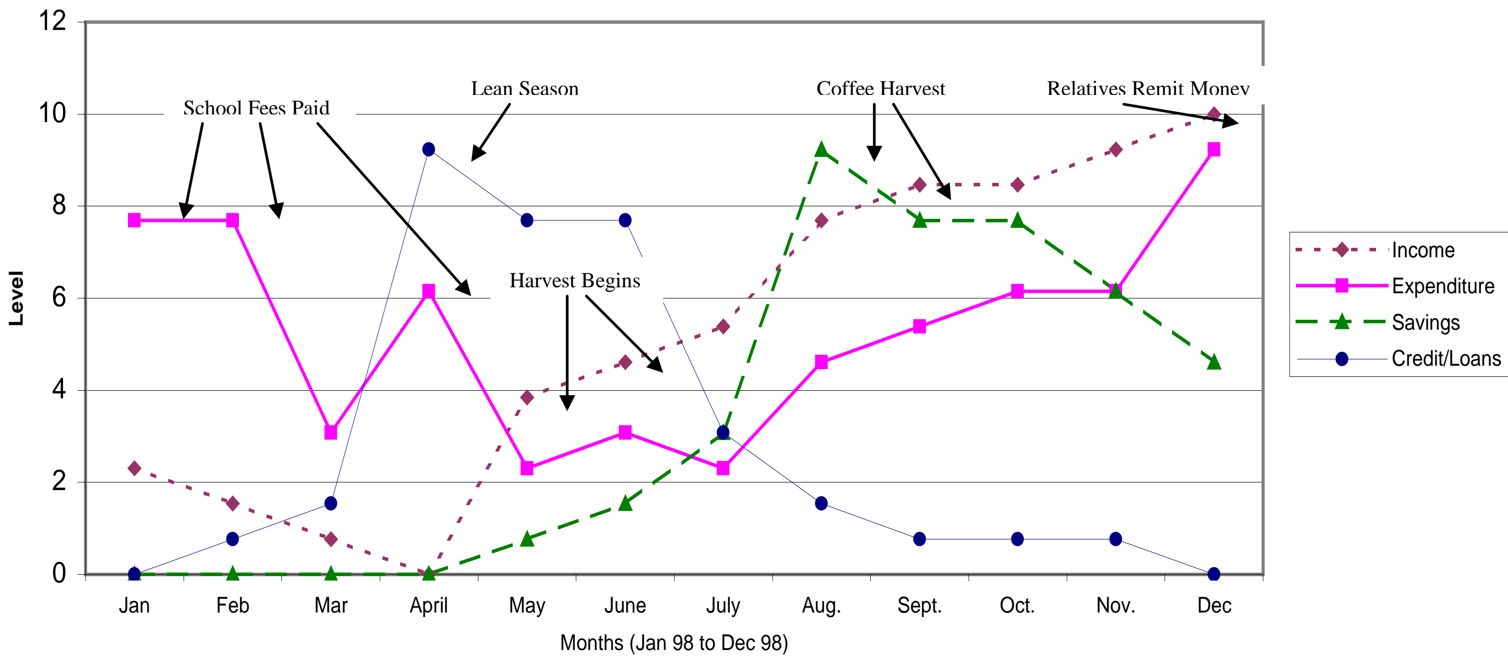
However, there is an additional problem posed by offering client-determined loans. One of the most effective mechanisms used by MFIs to screen credit-worthiness is to insist that clients build up a credit history, becoming eligible for larger loans only when they have paid off smaller ones - it would probably be unwise to change this. Nonetheless it is clear that excessively inflexible systems may well be forcing clients into multiple membership. This presents a tremendous opportunity for MFIs committed to a more flexible, quality financial services approach.

On the credit side, if MFIs were able to better identify clients' needs, and those clients who could manage and effectively use larger loans, they could attract and retain those valuable clients, while also better supporting their businesses. Similarly, if MFIs were able to better understand and respond to clients' needs for savings products, they could attract more capital to fund the larger loans. When an MFI offers a package of quality financial services that respond to all the needs of its clients, they are much less likely to take out multiple membership, and more likely to be willing to pay a premium for the convenience of having all their needs met by one institution, in one meeting. It is this comparative advantage of BURO, Tangail's client-responsive system that allows the organisation to charge an interest rate on loans that is effectively almost double that of Grameen Bank or ASA - and still attract clients. Indeed BURO, Tangail experienced a drop-out rate of only 3% in 1997 - the majority of these drop-outs are likely to have been driven by migration (particularly as younger women members get married and move to their new husbands' villages).

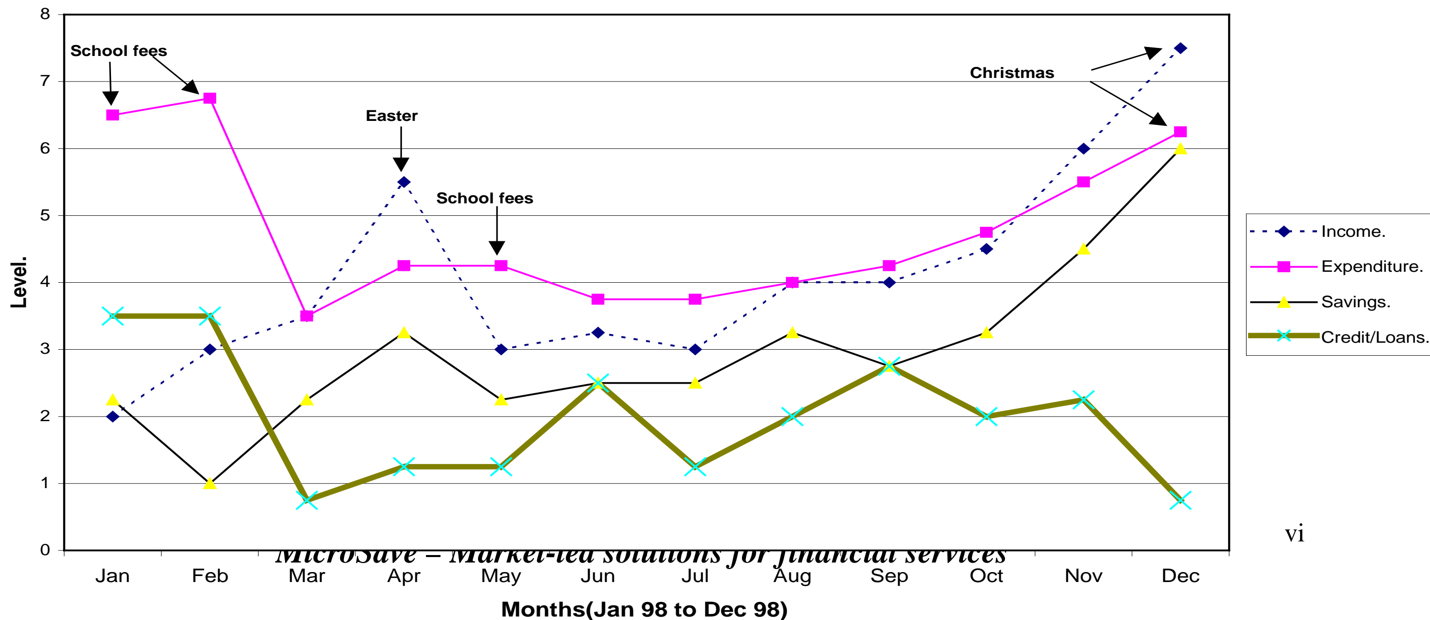
APPENDIX 4
SEASONALITY ANAYSIS

Urban Kampala seasonality calendars (see chart below) revealed that many of the businesses operated by UWFT clients suffer from instabilities caused by seasonal swings in demand. Many of the trading and retailing activities generate the highest returns around Christmas (November, December) and Easter (April) with the periods between January and February and May to October often leaving business and household severely strapped for cash. This situation is aggravated by the seasonal pattern of major out-goings especially education-related expenditures, which peak at the beginning of the terms in January/February, May and September/November. These additional demands very often trigger crisis situations for the less well-off and/or those with large numbers of children. Rural seasonality calendars are discussed in the main text of the report.

Rural seasonality of income, expenditure, savings and credit



Urban seasonality of income, expenditure, savings and credit.



APPENDIX 5

In Their Own Words

from

"Vulnerability, Risks, Assets And Empowerment – The Impact Of Microfinance On Poverty Alleviation"

Graham A.N. Wright, Deborah Kasente, Germina Ssemogerere and Leonard Mutesasira, 1999

As part of the Focus Group Discussions, the clients were asked to describe the "poor" and the "rich" in their community. The clients asked to add a category (to which they claimed to belong) the "not-so-poor". There was a remarkable consistency in their descriptions, which are summarised below.

The Not-So-Poor

In these households either the husband or the wife has low paying but steady work, giving good household income - although it may not be enough for the month. Nonetheless, the household makes some savings in readiness for contingencies. In addition, a typical not-so-poor household has a few consumer-durables (e.g. TV, radio, bicycle). The household can afford more than one meal a day but cannot afford a well-balanced diet. The not-so-poor sometimes own their own houses, but usually live in rented accommodation. Many of the not-so-poor suffer from threat of eviction for non-payment of rent on these houses. However, one member of the household may have a bit of working capital for micro-enterprises – one way or another they can afford the group membership fees needed to access loans from MFIs. Not-so-poor women can find the time to attend mobilisation seminars to learn how to earn more and save too. They will have access to more information by participating in women associations, and receive advice from peers on many subjects including their businesses.

All the children of the not-so-poor attend day schools and live in their homes because parents cannot afford boarding school. They can however, afford all the UPE requirements and send all their children to secondary schools, although they sometimes have to pay school fees in instalments. This is a recurrent problem for the not-so-poor and sometimes their children are unable to pass examinations because they miss classes due to non-payment of school fees. However, the not-so-poor have clean children, who wear clean clothes and share fairly good quality bedding at night. The not-so-poor sometimes attempt to assist children of relatives (e.g. orphans) by paying for their school fees. They also have many family members who come from the village with the impression that their town relatives are rich – these relatives are quick to consume but reluctant to work.

Not all of the members of not-so-poor households can be taken to hospital in the event of illness because they cannot afford all the bills. However, a not-so-poor household generally has friends to help in times of need, and the households are able to participate in the political life of their communities. Among these households, there is less domestic violence, and the husband and wife start planning together. The community and neighbours usually trust and respect these people.

APPENDIX 6
For Comparison: Group Guarantee At Home in Bangladesh
From Wright *forthcoming*

"Peer pressure and peer support", "group guarantee", "joint liability", or "social collateral" are viewed as one of the cornerstones of "solidarity group" credit programmes. It is this part of the Grameen Bank system that has been most discussed and replicated as the basis for MicroCredit programmes all over the world. In some respects, the "success of group guarantee" is seen as "the magic of Grameen". But there are increasing numbers of commentators and practitioners who have come to the conclusion that while "group guarantee" may be important and work for the first few loan cycles, thereafter, it weakens and becomes largely irrelevant (Yaqub, 1995; Sharif, 1997). Other factors have been identified as critical, and amongst these, the continuing access to repeat loans (which is of course, implicit in the group guarantee system) is probably the most important (Berenbach and Guzman, 1994; Rhyne and Otero, 1994).

"What Is Behind GB's Success ?

1. *Close Relationship*
The close relationship that is developed between the bank and the borrower, and among the borrowers themselves, is a very important factor in the success of GB.
2. *Peer Pressure and Peer Support*
Formation of small five-member groups of the members' own choosing and federating the groups into centres, helps create the right kind of peer pressure at the time when a member tries wilfully to violate GB rules, and peer support at times when a member falls into any difficulty in pursuing his economic pursuit."

(*Professor Md. Yunus, in Gibbons, 1992*).

The idea that Grameen, or indeed any other "solidarity group", members are likely to offer much peer support to one another has already been explored in the context of community organisation and social mobilisation in the chapter "MicroFinance: The Solution Or A Problem ?". If peer support is likely to work anywhere, surely it must be in the mature (ten plus years old) Grameen groups in Tangail. But there Todd's (1996) work showed that, "Members *did* help one another out with repayment, since default of one member threatened the new loans of the other members in her group and the good name of the whole center. But this help had distinct limits. More general help for members in trouble was rare. … In these villages, the groups and centers pulled together in unity when their access to loans was a stake. Otherwise more primordial loyalties and support networks of family, *gusti*, and even *dol* usually took precedence."

Even if peer support only works in order to ensure continuing access to loans, could it be that peer pressure and the group guarantee principle, is more effective ? Are the group members ensuring that defaulters pay ? Jain (1996) notes that in the case of Grameen Bank, the group guarantee principle was the subject of much training and discussion, but that members who fell behind on repayments were usually visited in their households on an *individual basis* by the Bank staff.

Matin's (1997) work in old Grameen *kendras* (established in 1980) in Madhurpur found, "In all the centres in these four villages the repayment rate has fallen drastically and the numbers of inactive borrowers have risen. ... Many of the borrowers who have overdue loans have stopped repaying

altogether, some are repaying part of their dues as and when convenient, and a few remain good payers. Those who still remain good repayers are getting new loans. Staff pressure and concomitant peer pressure is almost non-existent. The whole system is now operating on the basis of individual liability. ... Thus the only way in which joint liability works is via the staff pressure induced peer pressure which is directed at the centre to solve "*kisti* problem". This works as long as the "*kisti* problem" is manageable, that is when there are a few with "*kisti* problem", and when the "*kisti*" is small. But this is not sustainable. ... A point could be reached where eliminating the "problem borrowers" which is often to "clean" the centre becomes difficult as a borrower's overdue amount far exceeds her Group Fund contributions. As numbers of on-time repayers decrease, an "unzipping" effect is likely. This would render staff pressure induced peer pressure increasingly ineffective."

The "unzipping" effect[26] Matin refers to is when the entire group, and indeed often the entire *kendra*, burdened by excessive or multiple default, sees no further hope for continuing loans and elects to default *en masse*, thus causing the group or *kendra* (and the group guarantee that held it together) to "unzip". It is this risk that drives MFI field workers to continue to give loans to the good payers in the longer established groups or *kendras* - after all they have developed a long credit history - and thus to negate the group guarantee principle. And it is for this reason that, despite all the rhetoric, the effectiveness of the group guarantee principle is limited to the first few loan cycles.

In addition, from Matin's work, we can see that not only must staff induce "peer pressure", but also that "group guarantee" has a declining influence over time. Furthermore, the study also demonstrates that the "Group Fund" is playing a significant and important role as a "loan guarantee fund", and indeed, some commentators have suggested that it is better, honestly, labelled as such (Wright et al., 1997). We will return to the importance of the Group Fund and other compulsory savings systems in the chapter "Moving The Mountains: Savings As A Human Right In Bangladesh".

Yaqub's (1995) work on BRAC found other, related, problems with the group guarantee system. The longer members had been with BRAC and the bigger their loans, the less likely they were to accept the group guarantee principle. Yaqub attributes this to the fact that "GBF [Group Based Finance] relies ... substantially on the borrowers' lack of alternative sources of credit and social powerlessness." Yaqub goes on to conclude (as discussed in the chapter "MicroFinance: The Solution Or A Problem") that clients involved in MicroFinance programmes gain experience, self-confidence, (and in some cases, like BRAC, education), and increased income and wealth too. These attributes enable clients to seek and find better alternatives and to absorb whatever sanctions are threatened by the MFI (or fellow group members) in the attempts to recover the loan. And so the group guarantee principle, which depends on the financial and social weakness of those involved, is compromised by the very positive outcomes that access to financial services and the MFIs' services promote.

There is one other area in which the "joint liability" may be stressed to breaking-point, and this too may offer explanations why "group solidarity" and "peer support" instead of increasing over time, appear to decrease. The problem is different loan sizes. As groups mature, in those MFIs that do not <u>force</u> their clients all to take larger and larger loans, different members take differing amounts of credit. In extreme cases, some members of a guarantee group may be taking loans ten or more

[26] A term first coined by Rutherford during 1992

times larger than those of their fellow group members. The members with smaller (or in some cases, no) loans must then assume joint liability for much larger loans than they are ever likely to take - and may be unwilling to do so. It is likely that their desire for continuing access to credit facilities will mean that they will assume joint liability in theory, but that they will feel little obligation to "group guarantee" in practice. Hence Jain and Matin's observation that with more mature groups, the joint is transmuted into individual liability - a reality recognised and acted upon by the Grameen field staff.

Rogaly (1996) also notes that, "Peer group monitoring has not proved necessary to other institutions seeking to do away with physical collateral. Chaves and Gonzalez-Vega (1996) document the use of character references and locally recruited lending agents by government-sponsored banks in Indonesia. The degree to which Grameen Bank employees themselves implement peer-group monitoring has recently been questioned, with the suggestion that the key to its high repayment rates are the weekly public meetings (at which attendance is compulsory) to collect loan instalments and savings deposits. These induce a culture of discipline, routinised payments, and institutional accountability (Jain, 1996)."

Once again, there is a consistent theme running through these apparently diverse studies. In common with the work of Todd (1996), Matin (1997) and Yaqub (1995) stress the importance to clients of continuing access to loans, while Jain (1996) puts emphasis on the disciplined weekly repayments as well as the transparent accountability of Grameen's staff as providers of financial services. It is not unreasonable to suggest therefore, that the more clients value and appreciate the financial services being offered to them, the more they will do to protect and sustain their access to those services, and therefore the less likely they are to default. And the better the quality of those financial services (both credit and savings facilities, and the manner in which they are delivered), the more the clients will value them.

It may be for this reason that BURO, Tangail, which has introduced innovations that are popular with its clients and more flexible financial services than the hundreds of other MFIs operating in Tangail - including Grameen, BRAC, ASA, and Proshika (Rutherford and Hossain, 1997) - has a remarkably low default rate. As of December 31, 1997, only 1.05% of loans had repayment instalments more than 26 weeks overdue - of which many date back to the old BURO days. BURO, Tangail's clients appreciate the organisation's flexible financial services (and in particular its unique savings facilities and entirely optional loans), and therefore protect their access to these by repaying the loans they take on time.

APPENDIX 7
Key Interviews

At the Front Line: Interviews with Credit Officers (1)

A credit officer told us that she has two severely problematic groups. One of these groups, one is 18 months old, so the members are in their 3rd and 4th loan cycles. There have been at least 12 drop-outs, most of them in the last eight months. One 5 person cell was dropped in its entirety four months back: this was because three of them "deliberately" defaulted, and then disappeared from their work places. The other two were paying OK but their savings were not large enough to cover the full default of the three bad payers: therefore they had all their savings confiscated and decided to leave. Another of the five person cells suffered two deaths from HIV/AIDS. Another cell consisted of poor payers who where finally pushed out by the group members, at least in theory … technically the credit officers do not have the right to expel clients.

The other problematic group is even more serious: there have been thirty drop-outs in 18 months, so the group as it is now constituted is virtually all new bar one or two old members who have big loans of around Ush. 800,000. The drop-outs were caused by poor payments.

We asked the officer “who leaves?”. She said very small business people - milk vendors, bread vendors, for example - who use loans for rent or on lend it, and are usually illiterate and poor. Some of them she says, are thieves. So increasingly groups are taking physical collateral from their fellow members: such things as sewing machines or refrigerators. Alternatively the groups themselves demand bigger loan security funds than is demanded by the MFI’s rules. There is a special form for recording pledged goods.
She agrees that there is an upward drift of membership away from the poor towards richer entrants.

At the Front Line: Interviews with Credit Officers (2)

Of the 50 groups there are some very good ones but there are three that have had to be completely suspended because of repayment failure. The credit officer tells us that the fourth cycle is problematic - at that point loans reach the size which is very difficult to repay in 16 equal weekly instalments, especially by rural people with uncertain income. She is well aware that members complain about the inflexibility of this Village Bank-style system. However, the credit officer has had to resort to a policy of enforcing the group guarantee over the complete group rather than dealing with each five person cell as a solidarity unit. She says, rather wistfully, that in her view up the whole solidarity idea does not seem to work as well as she had been told in her training.

At the Front Line: Interviews with Credit Officers (3)

This credit officer had very clear ideas on how the MFI’s product might be improved, and of the strengths and weaknesses of the MFI’s product.

Possible areas of improvement on the current product:
- Size of the starting loan
- The ceiling should also be opened that is give out loans bigger than Ush. 800,000.
- The group size should be revised

- In addition, the time of payment for some people is too long and they have to wait for the entire group; And for some its too short-these are mostly small earners who need the cycle to be extended.
- Some businesses make money after two weeks not one week, some consideration should be given to them.

Strengths of the MFI's product:

- Its delivered to the ladies/clients directly. The MFI reaches out to the them, they do not have to travel to MFI's offices, and therefore it is cheaper.
- Gives loans to the poorest of the poor as small as Ush. 50,000.
- Gives additional training for example how to manage their businesses, book keeping etc.
- Encourages savings.
- Provides insurance for their money.
- The MFI's product is offered in towns and rural areas.
- Ladies acquire additional skills – for example leadership skills.
- Ladies interact and are exposed to the outer world, which would not be possible at home.

Near the Front Line: An Interview with a Branch Manager

A branch manager gave us the reasons why he felt that clients were dropping-out.

- ♦ Seasonal economic depression in rural areas related to draught and famine. This is the highest cause of drop-outs who disappear because they are unable to repay. The client/micro-enterprenuers are greatly affected by the rural economy because most of the customers are from the villages. This causes cashflow and therefore repayment problems.
- ♦ The second biggest exodus happens in the 1st and 2nd loan which we look at as a testing loan. This is when those with a culture of non payment are discovered and flushed out by fellow members of the group. This is when those that faked businesses are discovered.
- ♦ The next highest cause of drop-outs is the need for accessing savings. According to the MFI's policy if you want access to savings you have to leave. If one wants to settle arrears with compulsory savings/LIF one is immediately forced out regardless of how small the outstanding loan is compared to the savings. Most clients who have dropped-out under these circumstances do so because of extreme difficulties. A lot of them however restart with a first loan. The manager feels like giving people access to savings to deal with missed direct payments could significantly reduce the drop-out rate. The drop-out rate is therefore exaggerated by the rigid policy.
- ♦ There are two ways of categorising drop-outs a) forced and b) voluntary. Most of the exits are forced. The majority of voluntary drop-outs are strategic before they are forced to exit because this means that they stand a chance of re-entering and starting afresh. Most voluntary drop-outs happen during the dry months of February to May.

Focusing on Drop-outs: Clients' Perspectives (1)

(*Note: The group has lost a lot of members, especially during the 6th and 7th cycle, the membership having dropped from the original 36 members to the current 23. The group is struggling to maintain this number. This group also has a ROSCA locally called "Kalulu".*)

- People drop out when businesses fail and the underlying reasons are tied to the time of school fees when parents are forced to dip into working capital to pay the school bills. Sometimes the loan itself is used to directly pay school fees yet the size of the business is too small to service the debt.
- People exit in search of bigger loans offered by competitors. Recently a new MFI has come on the scene with a more attractive product. Unless their MFI revises products in keeping with the competitive environment, it will have no clients. Most of the clients have already decided a ceiling on how much money beyond which they will not save with the existing MFI.
- Failure to treat clients as individuals, especially those that have completed their repayments who have to wait for the whole group in order to access the next loans. This is not the case with competitors. A lot of clients leave at the end of every cycle burdening the others to recruit and fill up the required number of members. This is very stressful and most of the members are tiring of it. They want to be dealt with on individual merit.
- Weekly repayments in the face of locked up savings put too much pressure - to the point that it makes little sense for one to continue.
- Many people have dropped out because the MFI is not sensitive to business cycle and conditions. An example was the recent crisis that affected many clients when the government put a ban on fish. Needless to say this paralysed a lot of businesses. In spite of this glaring problem the MFI did not even consider giving relief to these members but insisted on pressing them to repay. The explanation from the loan officers was that HQ had given the directive. After repaying some people left because they realised how little the MFI cared about them and what they really meant when they declare that they seek to help poor women. There are a lot of other devastating crisis (sickness) that strike families and leave them completely wiped out and unable to continue with the program. The MFI is completely blind to such problems and insist to get paid without delay as if nothing tragic had happened.
- Some of the members have exited for fear of losing assets in case of default. This has happened before. The people most plagued by this fear are especially the very poor who fear risking the very little they have on them.
- A lot of people (especially the careless and very poor) drop out during the 3rd cycle because they are unable to service the loan because the weekly repayments had become too big for them. Asked who the careless were they indicated that, "It is those people who lazy, sometimes alcoholics, do not plan and run very tiny stool stalls."

Focusing on Drop-outs: Clients' Perspectives (2)

A Focus Group discussion was held with 11 members of a group that had experienced a high drop-out rate, and the members came up with the following reasons for many people leaving the group.

- Transfers on job or area of residence has forced some of their members to leave the group, as members cannot attend the meetings and at times their new areas of residence could be very far from Jinja.
- One of the ladies complains that she is being taken as a drop-out because she missed a cycle. She says that she did not expect to get any profit from this loan cycle as the business was not doing well, but she is continuing with savings.

- The repayment period is so short, thus requiring big instalments at the time of making the weekly repayments, this was seen as a very important issue, the members suggested that the repayment period should go on increasing as the loan gets bigger and bigger.
- The loan size is not responsive to the changing economic conditions. Although this money could be used to buy a bale of second hand clothes in 1998, it's not possible today.
- The inconvenience of the time to attend the meetings was sighted as another factor, people dealing in second hand clothes for example cannot afford to lose a minute on Mondays and Thursdays because that's when they get the biggest number of customers. This group that meets on Monday at 9: 00 am and has lost all the members who deal in second hand clothes.
- Members say they do not have free access to their savings, and the second issue related to this is that the same savings could be attached in case some of the members fail to pay up their loans.
- The compulsory savings are a very big burden, when a member fails to continuously contribute the compulsory savings then she will not be given a loan. They say that loans are based on the savings, members do not see any reason for this since they are not allowed to use these savings in times of difficulty.
- The fines imposed on members for not attending meetings also forces people to drop out. In this particular group a fine of Ush. 1,000 is charged on members for every meeting missed.

Everybody Out !

We spoke to a drop out. She reports that in March of 1998 some officers of the MFI came to this small and rather poor looking market and announced their programme. We asked this interviewee whether there were any differences between what the officers said at that time and what they found when they joined the scheme. She said one big difference was that the whole group was cancelled and expelled when just a few people defaulted, and all of the savings were attached. Moreover, there was no one to make representations to when this happened.

We asked her what had attracted her to the MFI's scheme. She said she wanted to both save and to borrow. Her final ambition was to generate savings of Ush. 800,000 which would have been enough for her to fully stock her small pharmacy shop which would by that time have been built up through the use of the MFI's loans. Her shop has been there for five years (though there was one gap when she was ill for a few months). She estimates the stock value now at Ush. 470,000.

She said it was easy to find the five person group that was needed to join the MFI. They joined in March 1998 and got their first loan within one or two months of joining. The loan size was Ush. 150,000, followed by a second loan of Ush. 300,000 in August 1998. She used the first loan for a water connection to her shop and for stock. This first loan was paid back without any difficulty by all five members of her solidarity group. She said there was no diversion of loan use.

She used the second loan of Ush. 300,000 partly for stock for her shop but she gave Ush. 100,000 of it to her husband for his own business. Her husband used this money well and always made sure that he gave her the repayments and interest.

However, some other members in her five person group experienced repayment problems. Some of these members were men. There were therefore some delays in repaying their loans. Nevertheless they filled up application forms for a third loan. The MFI told them that they would get the third loan when all repayments had been made on the second loan, and that in the meantime they should

go on saving in order to have a cushion of security for the next loan cycle. Accordingly, some of them continued to save. However the MFI then suddenly cancelled not merely her own 5 person groups but the complete 50 person centre. Since only 15 out of the 50 members had completed their loans, these 15 members lost their savings and this money remains owing to them from the other 35 members. There has been attempt to reconcile these debts because the chairperson of the group, who is also a defaulter, prefers not to pursue the issue.

The Information Gap …

The research team met a pavement cigarette seller who sits outside the Centenary Bank premises in Kampala. She is a married woman with a husband who mends bicycles sitting on the pavement of a street in Kiyembe. They live in the slum of Bwaise. She has been selling a few cigarettes and other items in this location for about five years although there was one gap when she went back to the village. She pays the council Ush. 1,000 a week for her location. She values her total stock at Ush. 20,000 and on a good day her gross takings are Ush. 5,000. Although she sits outside the bank she knows only one person - someone back in the village - who has a bank account. Equally, she has never heard of Faulu, PRIDE or FINCA etc.

She manages her money by keeping up to Ush. 30,000 in a box at home. In addition she is in a ROSCA of four people who each put Ush. 1,000 per day into the scheme and take a weekly draw: this means that once in four weeks she gets a sum of Ush. 28,000 or more than enough to completely re-stock her business.

Too Poor To Trust ?

We talked to a man who failed to access credit from CERUDEB and decided not to open an account. He is about 38 years with a household of 9. He has 7 years of school. Asked why he did not join CERUDEB, he said, "I attended all the sensitisation seminars about opening an account and accessing credit. I learnt that Centenary was for people that had and not those without. I had only Ush. 20,000 and no project to show that I could be given money. The loan officer said that "Centenary does not buy people trousers but rather patches torn trousers." This means that people like me could not access credit. Initially I was only interested in opening a savings account but when I learnt I could even get a loan I thought I could get credit. When I failed to get a loan, I even lost interest in opening a savings account. I will give it some thought in the future though". Asked how he saved his money now, he said "I keep my money at home like a lot of people, if it accumulates I buy a chicken, goat or cow or seedlings. Asked what he does if he needed money for an emergency he said, "I cut and sell banana or sell a goat depending on what amount of money I need. There is always someone/trader who wants to buy *matooke*". Asked why he wanted to open a savings account he answered, "I wanted an account where I could safely keep money for school fees and also accumulate money to buy large items".

Focusing on the Reasons Why the Poor Excluded

We conducted a Focus Group Discussion with a several rural people on why poorer members of the community did not join MFIs. The following are the ideas they shared:

- A fear borrowing because they fear losing their property in case of failure to repay.

- Other fear the brevity or lack of grace period which does not match their cashflow since most are involved in agricultural projects.
- The weekly repayments are too close together which imposes pressure considering that many are already participating in ROSCAs.
- Some fear paying for defaulters.

APPENDIX 7

BURO, Tangail - An Overview

As Of December 31, 1998

Organisation: BURO, Tangail has been operating since 1989, and is dedicated to the economic development of the poor, primarily in Tangail district, with the Mission Statement: **"To establish an independent, sustainable organisation dedicated to providing effective flexible and responsive financial services to promote self-reliance among the rural poor in Bangladesh."**

Through years of careful operations research, BURO, Tangail has developed and implemented a programme which emphasises the importance of savings as well a credit, and has become one of the more innovative and influential NGOs operating in Bangladesh.

Savings and Credit Activities: BURO, Tangail encourages potential clients drawn from the poorer "target" section of the community to form groups, encourages them to save, and provides credit to capitalise their income generation activities. By charging rates of interest designed to cover implementation costs and contribute to the capitalisation of the organisation, BURO, Tangail has developed a cost-effective and sustainable savings and credit system that by 2001 will provide financial services to around 100,000 members in a geographically compact area.

Members' Participation: The BURO, Tangail system encourages the members to participate in the planning, implementation and monitoring of the financial services and village development activities provided by the organisation, through participatory workshops, PRA and the Customers' Consultative Groups.

Scope of Operations: BURO, Tangail provides flexible financial services to 1,362 villages in Tangail district through 41 branches, which are managed from a head office located in Tangail town. There are a total of 448 staff who undergo regular classroom and on-the-job training.

Savings: In the year to December 31, 1997, net savings, including members' emergency funds increased by 105% to US$ 797,858, and the weekly savings rate in mature branches continued to rise, and was significantly above (usually more than double, often triple) the projected/budgeted rate of US$ 0.125. In the year to December 31, 1998, net savings including members' emergency funds increased by 14% to US$863,915. The declining rate in the rise in net savings arose from the lifting of the requirement to hold 15% of loans taken in savings account and the members' need to withdraw savings to meet emergencies in the wake of the disastrous 1998 floods.

Loans: As of December 31, 1998 US$ 12,242,543 in loans had been disbursed, and US$ 8,106,841 had been recovered. The loan recovery rate further improved over previous years to 98.08% loanees with up-to-date repayment records (with only 1.03% of loans with repayment instalments more than 26 weeks overdue).

Capital Funds: As of December 31, 1998, donors had contributed US$ 2,210,180 (59%) of the total capital funds, and the 71,479 members had matched this with US$ 647,508 (17%) from branch profits and US$ 863,915 (24%) in their savings and emergency fund accounts.

Profitability and Cost Analysis: In 1998, BURO, Tangail made a profit of US$ 376,219 (excluding grants of US$ 272,680 (reflecting the high rate of expansion at present) and the cost of donated capital (imputed at 10%): US$ 193,377), and this brought the organisation's retained earnings to US$ 647,508. Total expenditure for 1998 was 12.7% of the loans disbursed.

For details of this financial data, see "BURO, Tangail At A Glance 1993-98"

BURO, Tangail
Operations Research: Philosophy and Methods

BURO, Tangail is unique in Bangladesh since (unlike the other better known NGOs) it has always offered its members access to all of their hard-earned savings. BURO, Tangail is committed to further enhance and improve the flexibility and responsiveness of its savings and credit facilities to meet the needs of its members.

BURO, Tangail has developed a programme of operations research to improve the flexibility of the financial services offered by the organisation, and to ensure that these are responsive to the members' needs. The operations research agenda is guided by:

i) the results of the organisation's attempts to improve the members' participation in its organisational and financial services development, including the Customers' Consultative Groups, PRA-based monitoring and evaluation techniques, and workshops with members and staff - i.e. client-based, or demand-driven, market research;
ii) the reviews of external consultants; and
iii) examination of successful products offered by other informal and semi-formal financial services providers.

Detailed design, costing and pricing of new products is undertaken by the Finance Director and his staff in collaboration with the Programme Implementation staff prior to the start of pilot testing. Pilot testing of new financial service products is conducted in well-established branches close to the head office in order to facilitate effective training, intervention and monitoring. Staff from these branches are trained in the new products and the accounting systems necessary to track them, and the pilot testing begins.

Senior staff from the Programme Implementation and Finance sections of head office then make regular visits to review the progress of pilot testing in the field. They examine staff, implementation, accounting and organisational issues and make any necessary recommendations on product design. The Customers' Consultative Groups are designed to allow clients to provide feedback on product design. Once the pilot has been running for a while, staff in the pilot Branches work with senior staff from the Finance section to examine profitability and liquidity issues, and to revisit the costing analysis and thus pricing of the product.

This process is further strengthened by an operations research review team of MicroFinance experts (researchers, practitioners and accountants) drawn from outside BURO, Tangail, which conducts periodic reviews of the progress of the operations research programme, implementation issues, and clients' perceptions of the financial service products being offered, as well as ideas and options for further research.

Once pilot testing is completed (the period required to complete pilot testing of different products has varied with the complexity of the product, the success of the pilot test, the need for revisions to the design and pricing of the product etc.), successful financial service products are extended out to other branches as quickly as possible, in a phased approach.

BURO, Tangail
Operations Research Programme

Until 1996, BURO, Tangail offered limited deposit (maximum Taka 50 per week) and limited withdrawals savings products (under which clients could only access their savings if they did not have a loan outstanding). The organisation also offered a traditional Grameen Bank-inspired loan programme, offering loans repayable in non-negotiable 50 weekly instalments. As part of its commitment to innovation and to offering the best possible services to its clients, BURO, Tangail is now developing and implementing new financial service products. New components of the programme proposed for testing and implementation include:

Savings Facilities

1. **Open Savings Deposits** - offering unlimited savings deposit opportunities (now introduced in all 40 branches).
2. **Open Savings Withdrawals System -** allowing open access to members' savings subject to maintaining 15% of the value of any loan outstanding (now introduced in all 40 branches).
3. **Total Open Savings Withdrawals System** - allowing open access to members' savings irrespective of whether they have a loan outstanding or not (currently being pilot tested in 1 branch).
4. **Fixed Term Deposit Scheme -** offering higher rates of interest for longer term (2, 5 and 10 years) contractual savings agreements (currently being pilot tested in 2 branches).

Credit Facilities

1. **Supplementary Loan System** - offering additional loans to maintain members' working capital (currently being pilot tested in 1 branch).
2. **Simple Prepayment Facilities** - allowing prepayment of loans when members have excess liquidity (now introduced in all 40 branches).
3. **Line of Credit System** - offering an overdraft facility (thus overcoming the problems of rigid repayment schedules that are so unresponsive to many members' business cycles) (currently being pilot tested in 2 branches).
4. **Business Loans** - larger loans of Tk. 20,000 - 75,000 for the more successful entrepreneurs among BURO, Tangail's members (currently being pilot tested in 3 branches).
5. **Leasing Loans** - larger loans of Tk. 20,000 - 75,000 to finance the acquisition of fixed assets (currently being pilot tested in 3 branches).
6. **Flexible Loan Repayment System** - offering longer repayment terms for repayment of the business and leasing loans and to assist poorer members repay their normal "general" loans (currently being pilot tested in 2 branches).
7. **Short-term Providential "Hand" Loans** - offering 3 month loans for emergency needs (currently being pilot tested in 2 branches).

BURO, Tangail believes in the open exchange of information to further the development process. It seeks to disseminate the results and findings of the programme and operations research to other NGOs (through the Credit Development Forum an umbrella organisation of over 300 savings and credit NGOs in Bangladesh), and to donors and other interested parties (through the BURO, Tangail donor support group and CGAP) and regular publication of annual reports and working papers.

Contact **BURO, Tangail** at:
18/Ka Pisciculture Housing Society, Ring Road, Shymoli, Dhaka 1207, Bangladesh
Tel. 880-2-815815 Fax. 880-2-9125492 E-mail. burot@bdmail.net

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