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Client Drop-outs From East African Microfinance Institutions

Research by Leonard Mutesasira, Henry Sempangi, Harry Mugwanga, John Kashangaki, Florence Maximambali, Christopher Lwoga, David Hulme, Graham Wright and Stuart Rutherford

Report drafted by David Hulme

Kampala, May 1999

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Executive Summary

Background

Thirteen micro-finance institutions (MFIs) in East Africa were studied to determine who drops out from MFIs, and why; and who does not join MFIs, and why? The study was conducted for ***MicroSave***, a UNDP and DFID (official British development aid) supported programme dedicated to improving financial services for the poor. The MFIs studied were all well established and, in relative national terms, represented large and medium-sized institutions. Several of them have been claimed to characterize 'best practice' at a national level. In addition, the representative MFIs pursued a range of different microfinance models - Grameen Bank replications, modified Grameen models, village banks, self-help groups and individual services. The operations, clients and drop-outs of these MFIs were studied in both urban and rural areas using qualitative and quantitative methods.

Targets and Coverage

The region's MFIs target vulnerable not-so-poor and (upper) poor micro and small entrepreneurs. They provide limited services to the (lower) poor and none to the very poor. Coverage is low, with only 1 to 2 percent of entrepreneurs reached. The poor do not join MFIs because of exclusion by other group members, self-exclusion, MFI staff and because MFI products are not attractive to them.

Drop-outs

MFIs refer to individuals who leave their programmes as 'drop-outs' or 'exits'. Drop-out rates are high in East Africa. One case reported a drop-outs rate reaching more than 60 percent per annum. Despite these apparently alarming rates, not all MFIs view this as a problem. While some organisations view drop-outs as a serious problem as they increase the costs of training, lead to raised unit costs for administration and are one of the factors constraining outreach and loan portfolio targets, other organisations and individuals (especially credit officers) view drop-outs as a good thing- 'You have to remove the weeds to get a good harvest'.

Conceptually it is possible to distinguish between voluntary drop-outs and those who are coerced. The former may be resting (i.e. they plan to re-join the MFI), transferring (i.e. they leave to join a different MFI) or withdrawing from MFI services entirely. The latter may be 'pushed out' by the MFI and its staff or by other clients of the MFI (i.e. fellow solidarity group members). In practice it is often difficult to identify a specific process for an individual and often both voluntary and coercive mechanisms are involved in an incidence of exit.

Different MFIs have different criteria for drop-outs. In the credit-driven programmes of many East African MFIs, those members who do not have outstanding loans, or who do not wish to take a loan in the next group loan cycle, are considered drop-outs, even if they retain savings with the MFI. Interestingly, such clients usually told us that they were 'resting' and planned to take a loan out in the near future. Some MFIs will not permit this and clients who do not immediately take a further loan are "balanced out" (i.e. have their savings returned to them, are removed from the books, and most start with the new client loan restrictions and formalities should they want a new loan).

MFI loans and savings services often do not meet client needs contributing to high drop-out rate. Clients drop-out for many reasons including:

1. All MFIs reported that drop-out rates increase when there is a downturn in the national economy and/or adverse climatic conditions for agriculture.
2. Most of the solidarity-based MFIs reported significant numbers of drop-outs during the initial period of member training. For some, this is also matched by significant numbers of drop-out after the first loan by clients who are 'testing' the MFI.
3. Most field staff cited predictable periods with higher drop-out rates but these varied between branches and MFIs. Typical 'problem times' were before and after Christmas, the Eid period, the period before harvest in rural areas and the time for payment of school fees.
4. Most MFIs experienced at least one major 'shake-out' when changes in agency policy or concerns about default or sustainability led to a rapid, forced exit of large numbers of clients.
5. A number of MFIs experienced increased drop-out rates because of management problems. This occurred when field staff was involved in fraud and when MFIs had cash flow problems and could not disburse approved loans to clients on time.

All demographic groups have drop-outs. All socio-economic categories of clients drop-out. Neither gender nor age is associated with increased drop-out rates. However, the reasons why clients decide to drop-out of an MFI vary greatly between different socio-economic groups. For example, poorer clients may drop-out if the average size of loans within a group rises to high levels, requiring them to guarantee much larger loans than they can take themselves. By contrast, wealthier drop-outs complain that the available loan is too small for them to bother with the organisation and its system of weekly meetings. Commonly, (lower) poor people are screened out through group selection processes, are scared off by savings and loan repayment requirements or drop-out during the initial training period. The degree to which poor clients encountering problems with compulsory savings and repayments are pushed out varies with the nature of the product and the behaviour of group members and credit officers.

Multiple Membership

A very small number of clients are in more than one MFI. This is to patch together bigger loans, access smaller loans more frequently or to test the quality of another MFI's service. In the same way that high drop-out rates are symptomatic of inappropriate financial products, so are high levels of multiple membership amongst MFIs.

Conclusion

The conclusion argues that client exit is a significant problem for MFIs. It increases the MFI's cost structure, discourages other clients and reduces prospects for sustainability. Dropping-out is not just bad for clients and individual MFIs, it is bad for the entire microfinance industry. There are now more MFI drop-outs in East Africa than there are active MFI clients! This could lead to a growing cohort of people who discourage friends and relatives from joining MFIs

To overcome this problem, MFIs need to monitor drop-outs more systematically and move away from the rigid, credit-driven, group based products that dominate their services. Field staff implement the MFIs' rigid models despite their day-to-day (often hour-to-hour) experience that it is unsuited to their clients' needs. Their clients have many different needs and these vary with season, stage of life, means of gaining a livelihood and a host of contingencies. Clients need loans for emergency medical and health bills, savings to pay school fees, insurance in case of the death of an adult income earner, a mortgage to build a house, a savings plan so they have a small retirement income, and many, many other needs.

A small number of MFIs have started to respond to this problem recently. They have incorporated drop-out rate monitoring into their management information system (MIS) are analysing trends and conducting market research with clients and former clients and are modifying policies and products. Only one agency, however, has gone so far as to consider changing its organisational culture - to focus on serving clients rather than disciplining them.

Added to the problems associated with drop-outs and limited outreach, is the problem of targeting. Despite the mission of many East African MFIs to work with ‘poor entrepreneurs’ and ‘micro entrepreneurs’ the sector has primarily focused on the vulnerable not-so-poor and those who have an asset base that can serve as collateral or quasi-collateral.

Development of products that attract and retain a broader range of clients by meeting client needs more effectively is needed. East African MFIs must undertake their own product development initiatives. These would facilitate (and are probably a pre-requisite for) the achievement of MFI missions and sustainability. A number of lines of pro-poor product development (including a variety of savings products, different types of loan products and insurance products) are identified in the report.

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1. INTRODUCTION

1.1 Background to the Study

Microfinance institutions (MFIs) in East Africa experience relatively high rates of client loss (commonly referred to as 'drop-out' or 'exit') compared to similar institutions in Asia and Latin America. This is undesirable as it increases the costs of service provision, is one of the reasons why most MFIs in the region remain small (and thus probably unsustainable) and suggests that MFIs are not meeting client needs.

This study seeks to improve the understanding of the extent to which and why clients drop- out of East African MFIs. A clear understanding should help facilitate efforts to address the problem of high drop-out rates. Specifically, this study seeks to:

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;
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.

(See Appendix 1 for terms of reference).

In its conclusion the report presents proposals about how drop-out rates might be reduced. Readers of this report may also wish to read a 'sister report' prepared at the same time by Stuart Rutherford **Savings and the Poor**: **The Methods, Use and Impact of Savings by the Poor of East Africa** (***MicroSave***).

1.2 Methodology

This study has been prepared from materials gathered in three country specific reports prepared by consultants in Kenya, Tanzania and Uganda (Appendix 2). These reports examined the issue of drop-outs using 13 representative MFIs (for details see Table 1.1 and for a full comparison see Appendices 3A, 3B and 3C). These MFIs were fully established and, in relative national terms, represented large and medium-sized institutions. Several of them have been claimed to represent 'best practice' at national level. In addition, they pursued a range of different microfinance models - Grameen Bank replications, modified Grameen models, village banks, self-help groups and individual services. The operations, clients and drop-outs of these MFIs were studied in both urban and rural areas. This approach has provided a broad cross-section of data on the region's MFIs which, when aggregated, provides a reasonably accurate reflection of the variety of experiences that are occurring in the East African region.

TABLE 1.1: MFIs Studied for this Report[1]

Country	MFI	Number of Clients (Approx)	Site of Study
Kenya	KREP	15,000	Nairobi, Nyeri
Kenya	KWFT	11,000	Nyeri, Karatina
Kenya	WEDCO	9,000	Kisumu and environs
Kenya	PRIDE (Kenya)	6,000	Thika
Kenya	NCCK	6,000	Nyeri, Embu
Tanzania	PRIDE	28,700	Dar-es-Salaam, Arusha
Tanzania	PTF	4,700	Dar-es-Salaam, Picha-ya-n
Tanzania	SEDA	4,500	Arusha
Uganda	PRIDE	20,000	Kampala, Jinja, Mbale
Uganda	FINCA	17,000	Jinja
Uganda	Centenary Bank[2]	11,000	Kampala, Mbale
Uganda	FOCCAS	7,000	Mbale, Tororo
Uganda	Faulu	4,000	Kampala

1. In addition, clients of the Co-operative Bank of Uganda (Tororo), YOSEFU (Dar-es-Salaam), MEDA (Dar-es-Salaam) and the Post Office Savings Bank of Kenya (Thika) were interviewed.
2. Centenary Bank has 11,000 savers, only a few of which can be classified as microfinance clients.

The study used a mix of data collection methods and focused particularly on qualitative methods.

The main methods were:
- To review of previous studies
- To conduct in depth interviews with MFI staff, clients, drop-outs, non-joiners and poor people
- To conduct focus group discussions with clients, non-joiners and poor people
- To perform participatory appraisals with clients, non-clients and poor people
- To collect and analyse quantitative data from MFI management information systems (MIS).

Details of data collection methods are described in Appendix 4.

1.3 The MFI Sector in East Africa

The MFI sectors are at different stages of development in each of the three countries of East Africa: Kenya, Tanzania and Uganda. Arguably, it is best developed in Kenya where, after a number of church-based initiatives in the 1960s and 1970s, the foundations of the industry were laid in the early 1980s with the establishment of NGOs such as K-REP and Kenya Women's Finance Trust (KWFT). Interest and knowledge grew over the 1980s and during the 1990s 8 to 10 MFIs with client numbers of several thousand had evolved. Most of these MFIs practice an adaptation of the Grameen Bank model.

In Uganda, the MFI sector did not really start until 1993. Progress has been rapid since that time and there are now nearly a dozen MFIs each with more than 3,000 clients. A variety of models are in operation: adapted Grameen Bank, village bank and individual models. In Tanzania, the MFI sector is relatively poorly developed reflecting the fact that the country has only recently adopted a policy of private sector development, and its previous antipathy to private banks and NGOs. PRIDE-Tanzania towers above all the other players in the sector in terms of client outreach and portfolio size.

While there are important differences among the MFI sectors in each country, a number of important similarities occur.

1. Most MFIs have NGO status and are thus not permitted to provide financial intermediation between savers and borrowers. This greatly limits the services they can provide.

2. Most MFIs have missions that seek to promote enterprise and assist the poor while achieving institutional sustainability. In practice they focus on providing services to small and micro-entrepreneurs, both poor and non-poor. They are only marginally involved in direct poverty reduction but do provide a means by which poor and non-poor clients cope with vulnerability to financial catastrophe.

3. In all three countries there are deep problems within the formal banking and finance system. A number of large banks have failed in all three countries in recent years, and the capacity of the regulators of the banking industry (the central banks) to monitor and discipline institutions are weak. This weakness has both technical and political foundations.

1.4 **Are Drop-outs a Problem for these MFIs?**

MFIs refer to individuals who leave their programmes as 'drop-outs' or 'exits'. Opinions varied amongst MFI senior managers and field staff as to whether drop-outs were a problem. In all cases, there were higher priority issues than client retention, particularly default and loan portfolio size. Increases where drop-outs were viewed as influencing these two variables, they were taken seriously. At one extreme were organisations and individuals (especially credit officers) that viewed drop-outs as a good thing, "You have to remove the weeds to get a good harvest." At the other extreme, were organisations that viewed drop-outs as a serious problem because they increase the cost of training, lead to raised unit costs for administration and are one of the factors constraining outreach and loan portfolio targets. Interestingly, two MFI market leaders, K-REP and PRIDE AFRICA in Tanzania, treat the issue at a policy level. They have conducted research on drop-outs and are actively searching for ways of keeping drop-out levels low. In addition, those MFIs that are beginning to consciously adopt a client-needs focus regard drop-outs as an indication of problems with the forms and quality of their service.

1.5 **Poverty and Vulnerability in East Africa**

Defining the Poor

MFIs and the development funds invested to support their activities are designed to alleviate poverty. It follows, therefore, that it is important that MFIs seek to target the poor. The 'poor' are defined as those with low levels of income, consumption and social power. The 'vulnerable' are defined as those who are likely to experience adverse 'shocks' and who have little capacity to cope. Throughout our work we have had to make informed judgements about who is poor and who is not. To assist us in this task, the society in East Africa was divided into five main socio-economic groups - the very poor, poor, upper poor, non-poor and wealthy (or 'rich'). The poor (be they "very-poor", "poor" or "upper poor") are viewed as having low incomes, limited assets and engaging in forms of occupation or livelihood that reflect these circumstances. Interviewees were placed in categories according to their income, assets and occupations (see Table 1.2).

Such exercises could sometimes be supplemented and reinforced by reference to existing literature. In Tanzania, for example, we were able to use a World Bank publication ***Voices of the Poor: Poverty and Social Capital in Tanzania*** (Deepa Narayan, World Bank, 1997, especially Chapter 2, What is Poverty?). The 'very poor' category was derived from Kenya's **National Poverty Action Plan**.

TABLE 1.2: The Occupational/Livelihood Characteristics of Different Socio-economic Groups

Socio-economic Group	Examples of Occupation or Livelihood Occupation	Ownership
Wealthy	• Professionals • Consultants • Commercial Ranchers • Senior Civil Servants • National Politicians	• Estate Owners • Factory Owners • Property Owners
Non-poor	• Established Small Enterprises • Shopkeepers • Skilled Factory Workers • Real Estate Dealers • Medium Size Farmers • Medium Size Ranchers • Teachers. • Nurses	• Taxi Owners • Fishing Boat Owners • Medium Size Hair Salon Owners
Upper Poor	• Market Traders • Unskilled Factory Workers • Small Farmers • Fishermen • Established Hawkers	• Small Scale Livestock Keepers • Small Hair Salon Operators
Poor	• Street Hawkers • Cart Boys • Domestic Labourers • Peddlers • Plantation Workers • Sharecroppers	• Marginal Farmers • Marginal Pastoralists
Very Poor	• Unemployed • Deserted Women Microentrepreneurs • Elderly without support • Scavengers • Refugees • Beggars Charity • Disabled • Pastoralists in ASAL • Landless Casual Labourers • Assetless Casual Labourers • Street Children and AIDS orphans	

Identifying the Poor

By categorising people into economic groups as described, the research team were reasonably equipped to define who the poor are and where the poor are found. However, in each specific field visit, we had to face the problem of identifying the poor in that particular location. In this, the participatory exercise known as 'wealth-ranking' proved useful. Field staff of MFIs (generally known as credit officers) usually proved very articulate and cooperative when asked to rank their various groups by wealth and to explain their reasons for the rankings. In Tanzania, for example, a 45-kilometre drive out of the capital brought the team to a road-side village occupied both by long-term 'original' residents and by newcomers who had come to take up government or other formal jobs in offices and factories strung out along the highway. Asking small groups of members gathered for an MFI meeting about what kind (and what numbers) of people in their village were 'richer' and 'poorer' than themselves enabled us to identify one of the MFI groups as clearly poorer than the other. It also enabled us to visit the village to seek out the poorer residents and interview them.

Vulnerability

Poverty and wealth are dynamic conditions and not simply static socio-economic positions. MFI clients and non-clients that we met were actively engaged in trying to increase their wealth while at the same time trying to avoid sliding into poverty. Studies of poverty reveal that individuals and households commonly slide into poverty because they lack the capacity to cope with financial emergencies such as illness or death of an income-earner, medical expenses, death of animals, theft of an asset, closure of a market or workplace, drought, flood, fire or other calamities. People seek to reduce their vulnerability thus minimizing their risk of becoming poor or very poor. Some of the examples discussed in this report examine ways how clients, drop-outs and non-clients deal with vulnerability issues and how MFI services address such efforts.

2. WHO DROPS OUT AND WHY?

2.1 Defining Drop-outs

Drop-outs can be separated into two major groups- voluntary and forced. Conceptually it is possible to distinguish between voluntary drop-outs from those who are forced to drop-out (Figure 2.1). The former may be the result of resting (i.e. they plan to re-join the MFI), transferring (i.e. leaving to join a different MFI) or withdrawing from MFI services entirely. The latter may be 'pushed out' by the MFI and its staff, or by other clients of the MFI (i.e. fellow solidarity/guarantee group members). In practice it is often difficult to identify a specific process for an individual and often both voluntary and coercive mechanisms are involved in an exit.

2.2 Data on Drop-outs by MFI

Most of the MFIs studied collect data on drop-outs. Typically, a credit officer completes an 'exit form'. This form instructs administrative staff to remove a client from the MFI's records. It also identifies a reason for leaving, but these are the credit officers' interpretation and may not always be accurate. For example, while K-REP credit officers report that the major reason for dropping-out is due to business failure and/or client failure to make repayment instalments, K-REP drop-outs report that inappropriate MFI policies are the main factor (Table 2.1). Very few of the MFIs that monitor drop-out rates use those data as an indicator of agency performance.

TABLE 2.1: Reasons for Drop-out; Kenya

Reason	**Reasons in 1996 K-REP Survey**		**Reasons given by MFI (K-REP, KWFT, NCCK etc.) Drop-outs When Interviewed In the *MicroSave* Study**	
	#	%	#	%
Business failure/unable to repay	94	39%	12	19%
Indiscipline (absenteeism etc.)	51	21%	11	18%
Group Conflict or fraud	24	10%	8	13%
MFI policies	18	7%	19	31%
Re-location	21	9%	3	5%
Illness	11	4%	4	7%
Others	26	11%	5	8%
Total	245		62	

Source: *Kashangaki et al (1999)*

Different MFIs have different criteria for drop-outs and different methods for computing drop-out rate. This can skew the data making it difficult to directly compare agencies. In the fiercely pro-credit programmes of many East African MFIs those who do not have outstanding loans (or who do not wish to take a loan in the next group loan cycle) have exited, even if they retain savings with the MFI.

Interestingly, such people usually told us that they were 'resting' and planned to take a loan out in the near future. Some MFIs will not permit this and clients who do not immediately take a further loan are 'balanced out'. This means that they have their savings returned to them, are removed from the books, and are subjected to the new client loan restrictions should they want another loan at a later date. Such pro-credit/anti-savings MFI policies result in high drop-out rates (as will be discussed later) partly because many 'new clients' are actually established clients' who are rejoining.

A small number of MFIs adopt a less anti-savings approach and only count a client as a drop-out when both his/her loans and savings accounts are closed. Such organisations will clearly report lower levels of exit than those described earlier.

For example, FINCA classifies clients who drop-out of a loan cycle as drop-outs. Significant numbers of these people take out a loan in the next cycle after a 'rest' and are classified as 'new clients'. This said, it is evident that drop-out rates in East Africa are high relative to Bangladesh (see for example Wright, 2000) (Table 2.2). Qualitative research indicated that agencies that do not compute drop-out rates have above average drop-out rates.

TABLE 2.2 MFI Client Drop-out Rates in East Africa 1997 and 1998

Country	**MFI**	**Annual Drop-out Rate 1997 (%)**	**Annual Drop-out Rate 1998 (%)**
Kenya	K-REP	11	21
Kenya	KWFT	9	15
Tanzania	PRIDE[1]	not available	42
Uganda	FINCA	not available	60 (approx)
Uganda	PRIDE	43	68
Uganda	FOCCAS	n/a	13 (approx)

1. This data is only for the Arusha Branch

The lack of data and its analysis makes it hard to generalise about patterns of drop-out over time. Nevertheless, a number of common experiences can be drawn from qualitative information gathered by MFIs.

1. All MFIs reported that drop-out rates increase when there is a downturn in the national economy.

2. Adverse climatic conditions for agriculture increase drop-out rates.

3. Most of the solidarity-based MFIs (i.e. MFIs that require a group loan guarantee system) reported high numbers of drop-outs during the initial period of member training. For some, this is also matched by high numbers of drop-outs after the first loan - by clients who are 'testing' the MFI. A study by PRIDE Tanzania revealed that 84%of all drop-outs occurred before clients received a second loan (Appendix 5).
4. Most field staff cited periods in which drop-out rates were higher but these varied among branches and MFIs. Typical 'problem times' were before and after Christmas, the Eid period, the period before harvest in rural areas and the time for payment of school fees.

5. Most MFIs experienced at least one major 'shake-out' when changes in agency policies or concerns about default or sustainability led to many clients being forced to drop-out.

6. A number of MFIs experienced increased drop-out rates because of management problems. This occurred when an MFI had cash flow problems, due to field staff fraud or other problems, and could not disburse approved loans to clients on time.

2.3 **Socio-economic Characteristics of Drop-outs**

The research did not reveal a correlation between wealth and likelihood of dropping out. However, socio-economic status plays a tremendous role in the **reasons** that clients dropout; furthermore, socio-economic status is also closely tied to the likelihood that someone will or will not join an MFI's programme.

The reasons why clients decide to drop-out of MFIs vary greatly between different socio-economic groups. For example, poorer clients may drop-out if the average size of loans within a group rises to high levels requiring the poorer clients to guarantee (officially or unofficially) much larger loans than they can take themselves. By contrast, wealthier clients who drop-out of MFIs complain that the loan size is 'too small' for them to bother with the rigours of the organisation.

Level of education does not appear to influence drop-out rates. People with higher levels of education, who are likely to be wealthier, are no more or less likely to drop-out than clients with minimal education. Similarly in Kenya, a review of the relative economic status of 30 recent MFI drop-outs revealed that 8 (27 percent) of them had incomes below the average for their groups while 10 (33 percent) came from medium or upper income groups (i.e. had steady incomes that were above group averages).

These findings suggest that both poorer and wealthier clients have a similar propensity to drop-out (see Appendix 6 for details), depending on the nature of the financial services. However, our qualitative research, particularly in Uganda, suggested that clients on either extreme of the economic spectrum find MFI products less suited to their needs than 'average' clients, and are thus more likely to drop-out (Wright et al., 1999 and Wright, 1999).

The K-REP experience (Box 2.1) illustrates this well and shows the way in which product design determines who an MFI works with and who drops-out. When K-REP policy favoured large loans, many poorer members voluntarily withdrew from K-REP. By contrast, when loan sizes were reduced, wealthier members decided to drop-out. Interviews also revealed how personal preferences and circumstances shape drop-out behaviour. Both relatively wealthy and relatively poor drop-outs complained that solidarity group meetings were 'a waste of time' when they had better things to do and cited time demands as a reason for dropping-out. By contrast, a small number of other clients, both wealthier and poorer, reported positively on group meetings as an occasion to meet up with friends…. 'the best thing that happens each week'.

Poor/Upper-Poor Drop-outs

Few of the MFIs studied have significant proportions of clients who would be classified as 'poor' in terms of national poverty lines (see sections 1 and 3 for more details). Commonly, poor people are screened out through group selection processes, are scared off by savings and loan repayment requirements or drop-out during the initial training period.

However, many solidarity groups have some members from the 'upper poor' and occasionally the poor. There is evidence (particularly from our Uganda study) that the poorer drop-outs are pushed out of MFIs because of problems repaying their loans and/or meeting the savings requirements. Such difficulties affect poorer clients in particular because poorer clients have fewer assets and their income is less diversified than that of wealthier. Thus, the poor are more vulnerable to financial difficulties due to cyclical or unexpected economic downturns –such as drought, the weakening of the national economy, or some other crisis (e.g. illness, death of a family member, the closure of the Ugandan fishing industry). They have fewer ways of coping with such events and are more likely to miss repayments. While some drop-outs are permanently deterred from re-joining an MFI after such an experience, others view this as a temporary setback and when the immediate 'crisis' is overcome, they are keen to access loans from MFIs again (see the case of Josephine in Box 2.2).

Box 2.1 K-REP - Drifting Up and Shifting Down

In the mid-1990s, K-REP allowed its clients to rapidly expand their loans by a policy of the automatic doubling of loan size for those who repaid on schedule (or ahead of schedule). This encouraged relatively wealthier people to join and, after a few cycles, take out loans of K. Shs. 200,000 to 500,000 (US $ 3,200 to 8,000). Poorer group members began to drop-out, as they were concerned about guaranteeing such big loans, and so K-REP's clientele 'drifted up' to the non-poor, and the total number of clients fell. Just as bad, some tricksters joined K-REP, took out a series of loans that they rapidly repaid and then defaulted or disappeared once they had a large loan.

To reduce drop-out rates and re-focus on its target group of micro and small entrepreneurs K-REP changed its loan size policy. First loans are now K.Shs. 15,000 (US $ 240), second loans K. Shs. 17,000 (US $ 275) and third loans K. Shs. 20,000 (US $ 325). In some of the K-REP self-help groups (SHGs), clients reported that wealthier SHG members had dropped- out now that they could not rapidly develop a credit record that would give them access to large loans.

This experience illustrates the way in which product design influences client bases and drop-out demographics. Rapid access to large loans encouraged well-established entrepreneurs (and some fraudsters) to join K-REP while poorer clients dropped-out. Scaling down loan size growth allowed K-REP to 'shift down' to its target group but increased the rate at which relatively wealthier members dropped-out.

Box 2.2 Josephine The Vegetable Seller: Dropping out, Moving on, Coming back

Josephine is a successful retail vegetable trader at Nyeri Market. She is unmarried, has one child and lives in rented accommodation. She is originally from Karatina but by selling small quantities of vegetables and carefully saving at the Equity Building Society she has saved up enough to move to Nyeri and start trading in the market.

She kept her savings in Kenya Commercial Bank (KCB). However after hearing about the KREP Juhudi Credit Scheme, she got together a group of 30 people to join in 1993. "I wanted to improve my business ..this meant I could buy goods in larger quantities." She was Chair of the group and from an initial loan of KShs. 10,000 (US $ 160) she built up to KShs. 50,000 (US $ 800) in 1996. In that year disaster struck as she fell sick, needed medical treatment and could not do business. She 'balanced out' her loan by repaying with her savings and left the group.

In 1997, she was fit again. During 1998, she joined another MFI in Nyeri. She took one loan with this group but soon left as she did not like the way the MFI held the savings, rather than the members taking responsibility for their own savings. She has now formed another group of 30 people and has arranged for them to join the Juhudi Scheme.

The extent to which poor clients that encounter problems with compulsory savings and repayments are pushed out varies with the nature of the product and the behaviour of group members and credit officers. While some products, groups and credit officers will give a struggling client some time to 'catch up' with payments, others chase out clients after making them settle up, at the first sign of a problem. Some clients are aware of these differences as an interview in Uganda revealed: "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". Pride's approach, as described here, is good for financial discipline and repayment rates. However, it is likely to increase the level of vulnerability that poor people face, resulting in higher drop-out rates compared to wealthier clients whose assets and income flows permit them to cope more effectively with crisis situations.

Non-Poor: Average Drop-outs

The majority of East African MFI clients are small traders and business people who, while being far from wealthy, have incomes that place them above the national poverty line. We refer to these people as 'average clients'. If times are good (because of hard work and/or a favourable economic environment) these clients prosper. If times are bad (because of ill-health, emergency demands, bad business decisions or an economic downturn) these clients may sink below the poverty line.

The drop-out behaviours of these clients depend upon the nature of the MFI's product and the dynamics of the individual household's livelihood. Of particular importance is the relationship between loan size, loan timing and the capacity of a client to service that loan. When loan size and disbursement timing are determined by the client (within the boundaries set by the MFI), then the likelihood of a mismatch between these factors and repayment capacity can be reduced. However, many of the MFIs we studied operate group loan cycles with fixed dates by which clients are expected to sign up or drop-out. While many of these MFIs have policies of variable loan size, some credit officers pressure clients to take the maximum loan for their group's cycle. Where the virtuous circle of microcredit is operating (more investment, more turnover, more profit, more income, more investment, etc.) this is unproblematic. However, in other circumstances - saturated markets, seasonal production and trading, an economic downturn - clients find themselves taking on bigger loan repayments against a stagnant or decreasing income. At this stage, clients may drop-out or, if they take a bigger loan, encounter problems and be 'pushed out'.

In order to take full advantage of the potential client base, and to reach the target socio-economic groups, MFIs must determine common and predictable reasons for dropping-out. Farmers' income highs and lows are among the most predictable with seasonal cycles that correspond to both production and demand. The impact on drop-out rates of loan products that do not allow clients seasonal 'rest' periods is well illustrated in Box 2.4. Of the MFIs studied, only two had loan products that provide seasonal flexibility to meet client needs.

Box 2.3 Rose the Banana Trader

Rose grows vegetables and coffee with her husband on a small piece of land 20 kilometres outside of Jinja. Since she joined an MFI she has also been buying bananas locally and taking them to Jinja Town to retail. This has given her extra income. However, because the MFI she has joined insists that members keep on taking out loans, she has to try and sell bananas all the year round to get cash for repayments. This is very hard in the months after Christmas as quality bananas are harder to find and people have not got much money to spend. She thinks she may 'take a rest' for a cycle or two, 'balance' her loan off against her savings and probably rejoin next year.

None of the MFIs we studied have found a means of helping clients remain with the MFI when their business or personal circumstances is subjected to a major crisis. As revealed by the case of Josephine (Box 2.3), a successful and energetic entrepreneur can rise above the poverty level with the help of loans. However, the onset of a single major illness saw her slide back into poverty and drop-out because she was no longer able to meet weekly repayments.

By contrast, the chairman of a K-REP group in Nyeri is thinking of transferring to Faulu as he has not been able to expand loan size at the pace that he believes his electronics business could sustain. "I joined K-REP in 1995 and my business has really developed. But the biggest loan they will let me apply for next time is KShs.280,000 (US $ 4,500). My brother joined Faulu in 1997 and already has a loan of KShs. 300,000 (US $ 4,850)."

By virtue of their single and inflexible design, most MFIs appear to have created an incentive for successful clients to drop-out after 2 or 3 years. Clients of village bank schemes reported that they reap fewer benefits from the programs as the size of each loan becomes smaller relative to the size of the compulsory savings that is used to guarantee the loan. The figures (Table 2.4) bear this out with the percentage of compulsory savings against loan size rising from 25 percent for loan 1 to 75 percent for loan 9 although the difference between the loan and the savings remains the same. FINCA members in Kampala and Jinja reported that is the savings program is '…good early on', as it provides savings discipline and access to loans against savings. Later, it is a lot of effort to merely borrow your own money.

Table 2.4 FINCA Uganda: Compulsory Savings and Loan Size

Cycle	Loan Size (Ush.)	Compulsory Savings at Time of Disbursement (Ush.)	Compulsory Savings as a % of Loan
1	200,000	50,000	25
2	250,000	100,000	40
3	300,000	150,000	50
4	350,000	200,000	57
5	400,000	250,000	63
6	450,000	300,000	67
7	500,000	350,000	70
8	550,000	400,000	73
9	600,000	450,000	75

The products of most East African MFIs are aimed at 'average clients' and as a consequence, members of this category with stable businesses that have opportunities for expansion are likely to display relatively low rates of drop-out. However, when average clients do well (and become wealthy) or do badly (and slip into poverty) the inflexible products offered by MFIs become less attractive.

Relatively Well-off Drop-outs

Despite their focus on 'poor entrepreneurs' the MFIs that we studied had some clients who were well-established, relatively well-off, business. In many cases, of the success of such client is due in part to well-used loans from the MFI. These loans have helped clients to raise their socio-economic status (for example see Box 2.5). In other cases, people who were already well off were directly recruited. This is particularly the case in groups with a core of prosperous entrepreneurs and from which less successful clients have dropped-out. Such groups usually seek to recruit people in their own socio-economic niche and so go directly to wealthier people.

Box 2.4 A Watano of Successful Entrepreneurs in Nyeri, Kenya

A K-REP group in Nyeri started in 1995. It has shrunk from 30 to 15 (4 women and 11 men) of whom 8 were founder members. These 8 have all prospered: all of them now own cars and most of them are operating two businesses. They are recruiting new members but find it hard as "…we do not want the micros [micro entrepreneurs] as they have problems with repayments…but it is hard to recruit people like us as most of them say the K-REP first loan is too small to bother with."

Why do these 8 stay with K-REP? They report that "…getting loans from banks is too hard…you have to pay lawyer's fees, land valuation fees, and so on, which cost a lot…and it takes a lot of trouble." They have also set up a merry-go-round with weekly contributions of KShs. 5,000 (US $ 80) each. In addition, there is great camaraderie between the 8 founder members and this creates an opportunity for them to meet each week.

One female K-REP member has recently joined KWFT. She wants to test it and hopes to access more credit by being a member of two MFIs. She and her husband run several businesses and find credit a constraint on business growth " …the repayments are not a problem…our problem is getting enough credit to finance our businesses."

As discussed at the beginning of this section, wealthier clients sometimes show a propensity to drop-out. The main reasons for this are:

1. The desire for larger loans as the maximum loans given by MFIs are 'too small' for their growing businesses.
2. Annoyance at having anticipated loans delayed because of other group members being in arrears.
3. Frustration with the amount of time spent in group meetings and in trying to recruit new members to replace drop-outs. As a Kampala shopkeeper told us, "Meeting time is killing my business."

These factors commonly lead to wealthier members exploring the possibility of transferring to an MFI that offers larger loans, joining two MFIs at the same time (see Box 2.5), or joining a bank that can offer larger loans on an individual basis (as Centenary Bank is now doing in Uganda). In addition, where the core group membership is relatively wealthy then the Rotating Savings and Credit Associations (RoSCAs) that are linked to MFI groups often move into having large weekly contributions so that the payouts are substantial, enough to partially capitalise a rapidly growing business and make up for the limited size of the MFI loan!

Perhaps the most useful insights into the relationships between relatively well-off clients and MFIs are gained by turning our question on its head - why do relatively wealthy people remain clients of MFIs that target 'poor entrepreneurs'? Reasons include:

- A lack of competition, though that may be changing in Kenya (Co-operative Bank) and Uganda (Centenary Bank).
- The hope that these MFIs will eventually develop the types of product they need.
- The friendly social contacts they have developed (Box 2.4).
- Looking for the opportunity to turn a medium-sized loan into a grant, by defaulting (see Box 2.1).

2.4 **Other Issues**

Gender and Drop-outs

The research team looked closely at the issue of gender and drop-outs in each of the three countries. There was no clear evidence indicating that women were more or less likely to drop-out of MFIs that serve both men and women. While some credit officers in Uganda claimed that women were more likely than men to drop-out as "…women don't care much about it [repaying loans] … they have their husbands", others argued that there are more male drop-outs since "… they are stubborn and think they can get away with it [not repaying loans]."

A detailed examination of gender drop-out rates for 5,000 clients at PRIDE Tanzania's Arusha Branch found a virtually perfect match between recruitment shares and drop-out shares. The data shows that more women join but that of those that join, a similar percentage of men and women drop out (Table 2.3). A similar analysis of PRIDE Uganda's drop-out data confirmed this finding.

TABLE 2.3: Recruitment and Drop-out of PRIDE Tanzania Arusha Branch Clients by Gender, 1994 – 1998

	Clients Recruited		**Clients Dropped-Out**		
	Number	**%**	**Number**	**% of total**	**% recruits by gender**
Total	4,998	100	3,316	100	n/a
Female	3,301	66	2,122	64	64
Male	1,679	34	1,194	36	71

Source: *Branch Records*

There were reports in Kenya of 'husband influence', especially with reference to rural areas. This is when husbands seek to misappropriate their wife's loan and/or discourage women from participating in MFIs because of the threat of empowerment. We did not locate any specific examples of the former situation, while the latter leads to exclusion of certain women from MFIs (see Section 3) rather than dropout.

Age and Drop-outs
An analysis of PRIDE Tanzania's Arusha Branch revealed that age clearly plays a role in those individuals who are recruited and their likelihood to drop-out. The greatest number of recruits consisted of people between the ages of 25-45. Of the recruits who subsequently dropped-out, those younger than 21 dropped out at the highest rate, those older than 60 dropped-out at the lowest rate, while those between 21 and 60 dropped-out at a similar rate to one another (Table 2.4). Most MFIs insist that members must drop-out of the organisation on retirement because they cease to be an entrepreneur thus increasing the drop-out rate for this age group for different reasons than those of the younger recruits.

TABLE 2.4: Recruitment and Drop-out of PRIDE Tanzania Arusha Branch Clients by Age Groups, 1994 – 1998

Age	**Clients Recruited**		**Clients Dropped-Out**		
	Number	**%**	**Number**	**%**	**% w/in age**
Less than 21 years of age	21	0.4	17	0.5	81
21-30	1,180	23.6	760	23.0	64
31-40	2,315	46.3	1,526	46.0	66
41-50	1,144	22.9	796	24.0	70
51-60	269	5.4	177	5.3	66
More than 60 years of age	69	1.4	40	1.2	58
Total	4,998	100	3,316	100	n/a

Source*:Branch Records*

Occupation and Drop-outs
The main influence of occupation on MFI membership is to exclude labourers and employees from MFIs rather than influence drop-out patterns.

2.5 **Summing Up**
Drop-out rates in East African MFIs vary but in most cases they are relatively high reaching levels of up to 60 percent per annum. This imposes significant costs on agencies and retained clients and is one of the factors that explains why MFIs in East Africa have limited outreach. The reasons for drop-out vary between socio-economic groups and personal circumstances and preferences. Both poorer and wealthier clients show a propensity to drop-out.

While external factors - the economic climate, seasonality, natural calamities - influence exit rates, to a very high degree it is the design features of the MFI products that fuel drop-out. In particular drop-out rates are high because of:

- the requirement that clients keep taking loans regardless of enterprise needs and environmental context;
- the neglect of voluntary savings and insurance products in favour of focusing (typically) on a single credit product;
- a lack of product flexibility;
- the high costs imposed on clients - this is not merely in terms of interest rates but also compulsory savings, group-guarantees and meeting times.

The present products of MFIs in East Africa provide clients with high levels of incentive to drop-out, making the MFIs themselves responsible for much of the drop-out rate.

3. WHO DOES NOT JOIN AND WHY?

If drop-outs represent dissatisfied clients, or ones that are (for whatever reason) unable to use the product(s) on offer, those potential clients who chose not to join can help us understand both what makes MFIs' products or systems unattractive to their potential/target clients and how these issues might be addressed.

3.1 East African MFIs, Microenterprise and Poverty

Despite their profile in debates about enterprise development and poverty reduction the outreach of the region's MFIs is tiny. In Tanzania, there are less than 40,000 MFI clients against estimates of 4,000,000 informal enterprises in the country; so coverage is almost certainly less than 1 percent of the target population. In Kenya, it is slightly greater with 73,000 MFI clients. In parts of Asia (Bangladesh and Indonesia for example), the coverage rate is probably closer to 50% .- But then, of course, they do not have the same types of geographic and demographic challenges as MFIs in Africa present. The relatively good infrastructure and significantly more dense population make achieving these levels of coverage relatively more easy.

Similarly disappointing figures about outreach are produced if one relates MFI client numbers to the shares of national population's officially classified as living in poverty. In Kenya, with the region's most developed MFI sector then at best 3.5 percent of the country's poor have access to microfinance services given the most optimistic scenario. Given that large numbers of Kenyan MFI clients are non-poor the true figure probably lies between 1 and 2 percent.

A geographical analysis of the distribution of MFI operations reveals that these are usually focused on the more developed regions where levels of poverty are less intensive. For example, in Kenya the major MFIs are five times more likely to be operating in the 15 least poor districts than in the 15 poorest districts (Table 3.1).

In the country's five poorest districts there is only one small-scale MFI pilot project operating (Kashangaki et al 1999). A similar pattern (of MFIs serving the more accessible clients)is revealed at the local-level: MFIs operate around the main markets in urban centres and alongside the main roads (usually tarmac) in the most accessible areas. Yet poverty assessments and human development reports all agree that the greatest numbers of the poor (and the deepest levels of poverty) in the region is to be found in rural areas away from the tarmac (or paved) roads. The situations in Tanzania and Uganda mirror these findings from Kenya at best.

These facts should **not** be taken as an indication that MFIs should rapidly move into remote rural locations. There are good arguments about institutional sustainability and outreach pointing out that MFIs should start in relatively favourable areas and then diffuse out from these. And, in truth, none of East Africa's MFIs have developed an operational model that can deliver services 'off the tarmac' in rural areas and achieve acceptable levels of cost recovery. Delivering financial services using Grameen/FINCA-based systems with their weekly meetings necessitates relatively easy access for the MFIs' credit officers to attend these meetings. Furthermore, the weekly repayment regimes of these systems mean that the clients must have a relatively regular cashflow to meet their loan repayment obligations. Poor subsistence farmers rarely have such regular cashflows. Thus it is more operationally cost effective for the MFI to deliver services to the (typically relatively non-poor) people living in accessible areas – and it is that accessibility that gives those people the access to markets and employment opportunities that allow them to service their loans.

TABLE 3.1: The Distribution of MFI Services in Kenya and Poverty

Institution	**Presence in the 15 Least Poor Districts**	**Presence in the 15 Poorest Districts**
Faulu	6	0
K-REP	7	4
KWFT	8	1
NCCK	7	1
PRIDE (Kenya)	8	1
WEDCO	2	0
TOTAL	**38**	**7**

***Source**: Mugwanga et al (1999).*

What these points do illustrate is that great caution needs to be exercised in linking the terms of 'microfinance' and 'poverty' in this region. At present MFIs in East Africa are only peripherally engaged in direct deep-poverty reduction. Their main contribution is in reducing the vulnerability of the non-poor and upper poor, so that such clients have a reduced probability of sliding into poverty. There are also (arguably) important secondary effects of providing the vulnerable non-poor with financial services – including employment generation and economic multiplier effects (see Wright and Dondo – forthcoming).

3.2 **Socio-economic Characteristics and Access to MFIs**

The target clientele for all the MFIs studied, except Centenary Bank, are described as 'microenterprise and small enterprise owners', the 'productive poor', poor entrepreneurs' and the 'unemployed with micro-businesses'. Two MFIs, KWFT and FINCA, have a further qualification - they only work with female entrepreneurs. For Centenary Bank, the target is 'all Ugandans'.

The degree to which MFIs see enterprise development, poverty reduction and helping people cope with vulnerability as interwoven issues is unclear. While all MFIs clearly prioritise enterprise development, all of them receive financial support from organisations with a mission to reduce poverty. The degree to which these MFIs believe that their target group of micro and small entrepreneurs relates to the socio-economic status (very poor, poor, upper poor, non-poor, wealthy) of different households is ambiguous. This ambiguity has its advantages, not least of which is the access it permits to funds aimed at poverty-reduction.

Due to the challenges caused by a lack of infrastructure, language barriers, and subjectivity of the interviewees, assessing exactly who these various MFIs do and do not provide services to is a difficult task. However, we believe that assumptions and thus our subsequent conclusions are accurate based on the large numbers of MFIs clients, drop-outs, non clients and staff we have interviewed and observed (Table 3.2).

TABLE 3.2 Tentative Assessment Of Who Receives And Who Does Not Receive Services From East African MFIs

CATEGORY.	KENYA					TANZANIA			UGANDA				
	KREP	KWFT	NCCK	PRIDE	WEDCO	PTF	PRIDE	SEDA	CENTENY	FAULU	FINCA	FOCCAS	PRIDE.
WEALTHY	√	√	×	×	√	×	×	×	√	×	×	×	√
NON-POOR.	√	√	√	√	√	√	√	√	√	√	√	√	√
UPPER POOR.	√	√	√	√	√	√	√	√	×	√	√	√	√
POOR	√	×	√	×	√	×	×	×	×	×	√	√	×
VERY POOR.	×	×	×	×	×	×	×	×	×	×	×	×	×

√ = evidence of clients × = no evidence of clients

Notes:

1. These are findings based on field observations and interviews with clients and credit officers.

It is clear that East African MFIs do not work with the very poor (as is the case with most MFIs). Virtually all of the MFIs interviewed for this studied stated that they were working with the 'poor and non-poor' and that they did not work with the 'very poor' (Table 3.2). Their focus on working age adults operating enterprises means that they screen out the social groups that poverty assessments in all three countries class as the poorest - the landless in rural areas, the physically and mentally handicapped, the unemployed, households headed by people with no formal education (especially female headed ones), pastoralists in drought prone areas, unskilled casual urban and rural labourers, AIDS orphans, the elderly without support, street children and beggars. This is clear, is well understood by the MFIs and should not surprise anyone. However, this should not be presented as a judgement that simply by virtue of targeting those with a regular, monetary income, that MFIs do not help the poor at all and are thoroughly remiss in their pledge to contribute to poverty reduction. As noted above the provision of financial services to the vulnerable non-poor plays an important role in poverty prevention and providing an important platform on which these non-poor can build and develop their businesses and household security.

Nevertheless, what is surprising is that East African MFIs provide few services to poor people (see Table 3.2). That is services to households which are just about meeting their minimum daily needs but which have a high probability of slipping into desperate poverty if they have a financial emergency caused by illness of an income earner, loss of casual work, or theft of an asset for example. Many of the MFIs we studied do not serve this group. Those that do, only have a small number of such clients and are likely to move away from them because of pressures for institutional sustainability using the current programmes (see the next sub-section for a discussion of why MFIs do not work with the poor).

The main clientele of East African MFIs come from the upper poor and non-poor though mainly from a niche group within these - traders. It is hard to distinguish between the upper poor and lower non-poor because of the dynamics of enterprise growth (and stagnation and collapse). When the national economy is running well, the weather is kind and there are no calamities, significant numbers of micro-entrepreneurs will move from being upper poor to non-poor as income flows improve and they increase their assets. When the economic, political and natural environment are problematic, the reverse happens and significant numbers of micro-entrepreneurs may slip into poverty.

Our research suggests that the majority of MFI clients are non-poor. Clients come from households that can meet their daily needs, have access to primary education and basic health services, and that have accumulated some assets. Such people are by no means 'well off' but they have some capacity to cope with vulnerability (and being the client of an MFI may be part of this capacity), and do not face the same hardships as the poor. What is not clear, however, is the degree to which different MFIs are actively recruiting the non-poor as against recruiting the upper poor and helping them improve their socio-economic status (evidence of such beneficial impact is provided in Box 2.5). We suspect that MFIs started their programmes several years ago with the upper poor and have subsequently 'drifted up' into focusing on the non-poor. K-REP experienced this loss of valuable clients and has responded to the needs of the upper poor with a change in policy (Box 2.1). Other MFIs might well wish to consider this issue.

Finally, although in theory none of the MFIs studied (except Centenary Bank) work with wealthy clients, we found two different cases in which wealthy people were exploiting MFIs. In both of these, a wealthy individual had mobilised a group of poorer people (relatives, employees, dependants) to register as a group. The wealthy individual provides these 'ghost' members with their weekly savings and, after the meeting, collects up all the loans that have been disbursed!

3.3 **Why Don't the Poor Join**?

The poor are a heterogeneous and dynamic class concurrently slipping into deeper poverty and climbing out of poverty. For specific sub-groups there are different sets of reasons but we can generalise about the main factors that exclude the poor from MFIs.

1. *Mission Exclusion* - The majority of poor people (particularly the poorest) are not part of the target group for East African NGOs. –They are mostly the unemployed, labourers, refugees, the elderly, orphans, plantation workers and small agriculturalists.

2. *Exclusion by MFI Staff* - Large numbers of poor and upper poor people have not heard of MFIs even though they reside or work in areas where MFIs operate. This may be because they are 'invisible' to MFI staff or because staff avoid contact with the poor because they do not regard them as good prospective clients. Several MFI field officers with whom we researched in the field were quite open about their preference to work with the not-so-poor and non-poor. With targets (typically relating to number of clients, loan amounts disbursed and recovery rates) to meet from head office, some staff find that the poor are 'a waste of time'.

3. *Exclusion by Group Members* - All of the MFIs (except Centenary Bank) operate group-credit models. Group solidarity, however is a double-edged sword. It helps groups to pull together but also leads to groups taking on a group identity. For several MFI groups of non-poor/upper poor clients that were interviewed and observed, we noted a clear preference not to recruit replacement members from the poor. For example, some groups in Uganda had made a rule not to recruit hawkers because they have no fixed business and thus it is more difficult to seize assets from them if they have repayment problems. The fact that most MFIs now treat all members of a group as guarantors of loans to the group, means that groups increasingly seek to acquire members with collateral.

4. *Self Exclusion* - Poorer people commonly do not wish to join credit-based institutions. Poor and non-poor interviewees talked about 'the fear' of taking out a loan (especially for the first time) and, in particular, the poor were very frightened of the risk of losing the few assets that they have. Their lack of information about MFIs led some to believe that if things went wrong with a group they could be arrested from the house and sent to jail. In addition, many of the design features of East African MFI products - compulsory savings, timing of meetings, location of meetings - are

inappropriate for poorer people. As one lady from a rural area told us when asked why she would not join an MFI, "My husband cannot pay labourers to work in our garden when I am there [at weekly meetings]."

5. *Product Exclusion* - Building on this last point, a strong case can be made that the products offered by East African MFIs are designed to exclude poorer clients. They demand an increasing capacity to repay loans (regardless of season and economic circumstances), they have high transaction costs (inconvenient meeting places at inconvenient times), require that one has extensive social networks and will not give clients access to savings when they face a sudden emergency.

3.4 **Why Don't the Not-So-Poor Join**?

As shown above, the not-so-poor (upper poor/non poor) are the target group for MFIs. A host of reasons lead to such people not joining MFIs even when there is one recruiting near to their residence. These reasons are similar to those for drop-out (discussed in section 2). Of particular importance are:

- '**Fear**' - The not-so-poor remain vulnerable to sudden shocks and economic downturns, and are often reluctant to take the additional risk of a loan.

- **Transaction Costs** - The time taken by meetings, loss of access to compulsory savings, need to provide a guarantee for other clients mean that many not-so-poor see MFI services as not worth the limited benefits to be gained.

- **Product inflexibility** - Many not-so-poor individuals see the rigid designs of MFI services as not matching the specific needs of their economic and household activities.

3.5 **Why Don't the Wealthy Join?**

The wealthy are not a target group for East African MFIs and generally they self exclude. The only exceptions, and these are rare, occur when wealthy people see a way of aggregating multiple loans so that they can access a large amount of finance (see earlier).

4. **WHO HAS MULTIPLE MEMBERSHIP AND WHY**?

The issue of multiple membership provides a great opportunity for research on product development. Clients who adopt this strategy create a fabulous resource from which to gain an informed opinion about 'what do client want/need from our services' and 'how can we improve our services?'

During the course of this study, only five cases of multiple MFI membership were encountered. Such instances are rare, which is perhaps not surprising given the high transaction costs that multiple membership demands of a client.

There were three basic reasons for multiple membership:

1. **Testing**: One client had joined a second MFI in Kenya to test whether it provided a better service than the agency she had been a member of for 5 years. Once the test was complete, she planned to drop-out of one of the MFIs.

2. **Patching**: Another client sought a large amount of capital to expand her business. She had joined two MFIs to patch together a much larger amount of credit than either MFI would individually advance her.

3. **Timing**: A small number of people had joined two MFIs so as to get access to small/medium sized loans at regular intervals. By being in two schemes, a loan could be accessed more frequently, every 8 to 10 weeks.

5. CONCLUSIONS AND RECOMMENDATIONS

MFIs in East Africa experience high rates of client drop-out. This creates costs for the institution in terms of new client recruitment and training, and is one of the main reason that the region's MFIs have very low outreach levels. High drop-out rates have negative implications for MFI sustainability. In addition, these high drop-out rates increase client transaction costs (as the solidarity group systems require that clients become heavily involved in new member recruitment and training) which is likely to increase drop-out rates even further. Dropping-out is not just bad for clients and individual MFIs - it is bad for the entire microfinance industry. Over the last decade more clients have dropped out of MFI programmes in East Africa than there are active MFI clients! These figures could lead to a growing cohort of people who discourage friends and relatives from joining MFIs. This study has revealed not only the impact of high drop-out rates on clients and on the industry as a whole, but it has also begun to uncover the underlying causes. Thus it serves as a guide to direct further research geared towards developing programs that have the potential to produce more profit and greater sustainability by including poor clients and meeting the needs of this wider range of clients in a more appropriate and helpful manner.

A small number of MFIs have recently begun to respond the problem of high drop-out rates. They have incorporated drop-out rate monitoring into their MIS, and are analysing trends, conducting market research with clients and former clients, and modifying policies and products. There is a clear need for all of the region's MFIs to record and analyse drop-out rates at the branch level as a performance indicator. Only one agency, however, has gone so far as to think about changing its organisational culture - to focus on serving clients rather than disciplining them - in response to its drop-out problem.

Added to the problems of high drop-out rates and limited outreach is the problem of targeting. Despite the mission of many East African MFIs to work with 'poor entrepreneurs' and 'micro entrepreneurs', the sector has focused on the not-so-poor and those who have an asset base that can serve as collateral or quasi-collateral. The client base of East African MFIs differs markedly from that of the South Asian (and Latin American) MFIs upon which the East African MFIs modelled themselves. This is a dilemma in terms of 'mission drift' (i.e. losing focus on the MFIs' mission of poverty alleviation) and could cause problems in the future with poverty-focused aid donors and private sponsors. If MFIs wish to work with such agencies, they shall have to think much more about how they contribute to reducing the vulnerability of the poor and non-poor to sliding into poverty (or deeper poverty) and adjust their programmes to meet their obligations mandated by accepting funding from such agencies.

Clearly a large number of challenges and issues are involved in the inter-related problems of high drop-out rates, limited outreach and not providing services to the poor. Individual MFIs must work out the answers to regionally specific problems. It is possible, however, to chart out the main lines of action that MFIs will need to consider.

At the heart of the drop-out/outreach/targeting problem in East Africa lies the fact that MFIs in the region (with one or perhaps two notable exceptions) display an extraordinary degree of uniformity. As mentioned, a small number of ideas originating in Asia and Latin America have been used as models, and local experimentation and product development has been very limited resulting in many very similar programmes and products throughout the region almost without regard to special needs, potential and demographics. What is the nature of this uniformity?

- **A Uniform Mission**: Virtually all east African MFIs focus exclusively on loans for micro- and small enterprise.

- **A Uniform Analysis**: Virtually all East African MFIs assume that the financial service needs of poor and not-so-poor Africans, in urban and rural areas and in different sectors and activities, can be met by a sequence of business loans of increasing size. African households are assumed to behave as small firms investing in the production of a single product (or provision of a single service).

- **A Uniform Product**: While there are differences between the products offered by MFIs (see Appendices 3A, 3B and 3C) most offer only a single product and the core features of these products are almost identical:

- group structures and meetings
- group guarantees
- compulsory savings with low or no access
- quasi collateral (savings, pledges or an understanding that group members can seize the assets of those in arrears)
- fixed disbursement times
- strict control of client behaviour by rules.
- lack of a savings programme without loans.

Field staff implement this rigid model despite their day-to-day (often hour-to-hour) experience that it is unsuited to their clients' needs. Their clients have many different needs and these vary with season, stage in the life cycle, means of gaining a livelihood and a host of contingencies. They need loans for emergency medical and health bills, savings to pay school fees, insurance in case of the death of an adult income earner, a mortgage to build a house, a savings plan so they have a small retirement income, and many, many other needs. Field staff know that clients use their 'micro-enterprise loan' to fit into these complex household finances, but also know that they have to honour the model and pretend that their clients are a uniform group of microentrepreneurs. In other regions of the world, particularly South Asia, MFIs are increasingly moving away from group-based approaches in an effort to meet client needs while increasing the MFIs' sustainability. In East Africa this is not the case!

What is to be done? How can East African MFIs get out of the straight-jacket of group-based microenterprise credit that they are in and that gives them high drop-out rates, limited outreach and takes them away from priority clientele. The answer is quite simple - East African MFIs have put the jacket on, the strings are not tied, they can slip it off and try on other jackets - blazers, safari suits, double-breasted jackets and waistcoats! They need to **determine the desired client base, categorise that clientele (e. g. by lifecycle stage, locale, source of income), experiment with new products,** and **strengthen product development capacity** to produce micro-financial services that meet client needs from which the MFIs can levy charges that permit sustainability within the confines of local regulations[1].

What form should such new products take? Box 5.1 provides some hints and there are recommendations in the 'sister report' that accompanies this report (Rutherford et al 1999). The key point to note, however, is that East African MFIs must undertake their own product development initiatives - this is the only way to strengthen their long-term product development capacities. Learning from foreign MFIs and listening to visiting consultants are parts of that process. But more important still is asking field officers what is really happening, listening to clients and potential clients and trialing experimental products on a small scale basis. ***MicroSave*** can provide support (in the form of manuals, training and technical assistance) for such experiments. This support can assist MFIs to set-up their evaluations, design surveys, and perform the subsequent analysis.

The microfinance models that have been imported to East Africa have helped the region's MFIs reach their present stage of development but have bequeathed problems of high drop-out rates, limited outreach and mission drift as discussed above. The answers to these problems lie in East Africa - providing the region's MFIs are prepared to take the initiative and experiment.

[1] It should, however, be noted that the regulatory environment in all three East African countries currently prohibits MFIs from providing savings services to their clients. This represents a significant barrier to appropriate product development (see the sister study to this one "Savings and the Poor: The Methods, Use and Impact of Savings by the Poor of East Africa" by Stuart Rutherford).

Box 5.1 Microfinance Service Product Development: Some Ideas*

- Voluntary, open-access savings accounts
- School fee savings accounts
- Contractual savings
- Christmas/Diwali/Eid savings accounts
- Individual loan products for clients with a good credit history
- Immediate access emergency loans
- Flexible savings and loan accounts for individuals (see Rutherford et al (1999) for an example)
- Simple, low cost life insurance
- Funeral/burial insurance
- Other insurance products (in partnership with private insurance companies).

* New product development should aim to charge at rates that cover the full economic costs of the product.

ABBREVIATIONS:

FOCCAS	Foundation for Credit and Community Assistance (Uganda)
KCB	Kenya Commercial Bank
K-REP	Kenya Rural Enterprise Programme
KWFT	Kenya Women's Finance Trust
MFI	Micro-finance institution
MIS	Management information system
NCCK	National Council of Churches, Kenya
NGO	Non-governmental organisation
PTF	President's Trust Fund (Tanzania)
ROSCA	Rotating Savings and Credit Association (also known as cash-rounds, merry-go rounds and Upatu)
SEDA	Small Enterprise Development Association (Tanzania)

EXCHANGE RATES (May 1999)

During the study exchange rates fluctuated. The following rates have been used.

Ksh 62	=	US $ 1
Tsh 700	=	US $ 1
Ush 1450	=	US $ 1

APPENDIX 1

MicroSave

MicroSave - Market-led solutions for financial services

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Terms of Reference
For
Study on the Drop-Outs Among East African MFIs

General Background:
As a result of the Africa Conference on "Savings in the Context of Microfinance" held in February 1998 in Kampala, UNDP and DFID have started an initiative to promote savings services for poor people in Africa.

Savings have risen to the top of the MicroFinance community's agenda. Previously MicroFinance Institutions (MFIs) focused primarily on providing loans, and savings remained Vogel's (1984) "forgotten half", typically extracted from clients through MFIs' compulsory systems. There was a prevalent and powerful perception that "the poor cannot save", thus compulsory savings systems often required members to deposit small token amounts each week and levied more substantial amounts at source from loans. These compulsory savings were then often "locked-in" (usually as loan guarantee funds) until members left the organisation.

It is hardly surprising therefore, that poor clients view compulsory, locked-in savings not as a service, but as part of the cost of borrowing and significantly reduce their deposits. But there is increasing evidence (Montgomery, 1995; Wright et al., 1997; Rutherford, 1998, CGAP Working Group, 1998) that offering voluntary and accessible savings facilities may result in the inclusion of the poorest 10-15% of the population, who are averse to risk (and thus to taking credit), and are therefore not being served by most MFIs. For poorer households, savings can serve as invaluable reserves, as insurance, against the crisis factors such as illness, natural disaster and theft that can so easily drive the poor into destitution.

- ***MicroSave*** will conduct action-oriented research on savings products and their use by the poor.
- ***MicroSave*** will enter into partnership with five selected MFIs (comprising a wide-variety of institutional types) and local service providers to work on savings product development as part of a learning-by-doing agenda.
- On the basis of the two activities above ***MicroSave***, will disseminate information on savings-related issues to MFIs in Africa.
- ***MicroSave*** will work to enhance the capacity of local service providers to provide training and technical assistance on market research methods to examine clients' needs for savings products.
- ***MicroSave*** will work with AFCAP to prepare training curricula on savings product design, costing/pricing, pilot testing and evaluation.

Together, these activities will lead to the development of a comprehensive sustainable programme to build the capacity of MFIs seeking to provide secure high-quality savings services for poor people.

Specific Background:
There is increasing 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 clearly 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 training and "social preparation" 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 is 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 is 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;
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 will use qualitative research methods, in particular in-depth interviews with people who are clients of a variety of MFIs (formal sector banks with deepened outreach and NGO-MFIs). The study will also conduct interviews 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.

Geographic Scope:
The study will be focused on three countries in East Africa: Kenya, Tanzania and Uganda, and will chose sites where several MFIs (both formal sector banks with deepened outreach and NGOs) are operating in competition. To optimise the use of international consultants, the study will be run in parallel with the ***MicroSave*** study of the use and impact of savings services.

Implementation:
The study will be conducted by one international consultant with extensive experience in conducting client-perspective-based, qualitative research on MicroFinance-related issues. In this work he/she will be assisted by three local consultants drawn from the three countries where the study will be conducted. The international consultant will ensure effective transfer of qualitative research skills during the assignment so that ***MicroSave*** can work with and further develop the three local consultants.

Timing:
The study will run for a total of 30 working days (including travel) from around April 16 to May 31st. The international consultant will fly to Uganda to work with the study team on preparing and testing survey instruments and methods, and then on to Kenya to work with local consultants to start the work there, before returning to the UK while the local consultants complete the field work. Finally, the consultant will return to Uganda at the end of May to complete the final report writing with the study team. The study will be conducted in the second quarter of 1999.

Reporting:
The international consultant will be responsible for producing the report, in collaboration with the local consultants. The report should be delivered in draft form to ***MicroSave*** three days before leaving Uganda, and will be read and responded to within 1-2 days, thus allowing the consultant to finalise the report before leaving. The report must include a 3-5 page executive summary and be delivered in both hard copy and on diskette (in Word 7 or 6/95 format).

The report will include:

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.

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APPENDIX 2

Details of the Drop-out Studies in Kenya, Tanzania and Uganda

1. John Kashangaki with David Hulme and Harry Mugwanga (1999); **Study on Drop-outs Amongst Kenyan MFIs**. Kampala: ***MicroSave***.
2. Florence Maximambali with Stuart Rutherfold and Christopher Lwanga (1999); **Study on Drop-outs Amongst Tanzanian MFIs**. Kampala: ***MicroSave***.
3. Graham A.N. Wright, Leonard Mutesasira and Henry Sempangi with David Hulme and Stuart Rutherfold (1999); **Drop-outs Amongst Ugandan MFIs**. Kampala: ***MicroSave***.

APPENDIX 3A: Kenyan MFIs Studied: Matrix of Main Characteristics

KENYA	**KREP**	**KWFT**	**NCCK / SBDO**	**PRIDE**	**WEDCO**
Institutional Status	NGO	NGO	NGO	NGO	A project of CARE International.
Target group of clients	Micro, medium and small Enterprises	Female micro and small enterprise owners.			Women with enterprises
Year started	1984	1981	Started micro-lending activities in the 1970s.	1988.	1996 as WEDCO. 1983 as CARE
Institutional model	Juhudi an adaptation of Grameen,. Chikola an extension of ROSCAS and individual loans.	Aim for at least 20; 15 to 25 range. Have watanos of 3 to 7, main is 5; Monthly meetings at KWFT office or rented rooms(Modified grameen bank). Used to be weekly.	Group of 30; watanos of 5 meet weekly (no exceptions) ; any convenient place for members to meet.		Unrestricted groups; aim for average 25 members. Current average closer to 10.
Staff numbers	56 credit officers out of staff of 143. KREP involved in other activities besides credit	51 BDOs	*****		Total 49 Credit Officers 39
Current number of clients (or members)	13,201 clients at the end of March 1999.	523 groups wit 11,621 active clients at the end of March 1999.		6000 clients.	411 groups with 5000-6000 clients.
Current number of borrowers	9,889 borrowers at the end of March 1999.	8,149 borrowers at the end of March 1999.			****
Current number of savers	13,201 savers (Collateral savings)	11,621 savers. (Collateral savings)			N.A
Ratio credit officers to clients, to savers, to borrowers	1:236 officers to clients and savers 1:177 officers to borrowers	1:227 officers to clients and savers 1:160 officers to borrowers			
Value of savings held	86,million	66,million			24 million

KENYA	KREP	KWFT	NCCK / SBDO	PRIDE	WEDCO
Value of loans out-standing	268 million	94 million			64 million
Level of self-sufficiency	100% operational and Financial self-sufficiency.	75 % operational self-sufficiency and 69% financial self-sufficiency.			57.5% operational self sufficiency and 44% financial self sufficiency
Profit/loss last accounts period	Profit Ksh 10.2 million	Loss Ksh I.7 million			
Drop-outs rates with years	1997 - 1208 1998 - 2827	1997/8 - 593 1998/9 - 1712			Unknown at individual level. Have figures at group level but not readily available.
Reported arrears rate	Portfolio at risk from 1 day 10%				
Interest rates on loans	Juhudi 18.85% p.a flat rate; Chikola 20% p.a flat rate; Loan application fee 1%; Loan insurance fund 0.5%; Membership fee Kshs. 150/=; Passbook fee Kshs. 65/=.	22% over the year; Loan application fee 1%; Loan insurance fund 0.5%; Membership fee Kshs.200/= Passbook fee Kshs. 50/=.	22% flat rate per annum		2% p.m. 15 Groups 3% p.m. from Groups to members
Interest rates paid to savers	N.A Savings held in groups bank accounts.	Account is for group with KWFT signatory. Earns interest according to bank rates.			Equity deposit invested in term deposits. Saver gets at 2% above normal savings rate: KCB
Loan application procedures	Letter to group, guarantors advised to vet request. CO and group loans committee review application. Client deposits application fees and LIF to bank.	Five people apply then after 4 weeks of repaying another 12 apply. Application to group; loan committee visit the business; KWFT officer does	Loan application completed; a series of requirements like passport photos, Ids, Spouses Ids etc; attach minutes of group meeting that approved		Raise 20% of required loan; Branch manager may decide to approve loan lower than equity raised by group * 5. • Below Kshs 500,000/= decided at

KENYA	KREP	KWFT	NCCK / SBDO	PRIDE	WEDCO
		business assessment; Pledge form (Only first one needs authentication by advocate); attach licence, bank statement, ID, Photos; Officer takes form to KWFT office.	loan; Paper work sent to Nairobi for verification.		branch level. • Up Kshs. 800,000/= operations manager • Above Kshs.800,000/= involves CEO.
Loan disbursement procedure	Approved application sent to Accounts (HO), cheque signed and returned to CO to release at meeting.	Approval; Personal cheque issued; Given to client at next meeting	Cheque written (to applicant) at HQ; Sent to area office and delivered at group meeting.		The cheque is issued to the group during their meetings.
Loan repayment procedure	HO signatories. Below 50,000 RM & AM. Above 50,000 FM & MD.	Period can be 3,6,9,12 months; Pay monthly at meeting; Watonos collect and check the money; handed over to treasurer for banking after being checked by KWFT officer; Bring pay in slips to KWFT.	Rural area two weeks grace period; Equal payments over 50 or 26 or less weeks. (For 4th loan 18 months or less). Urban areas equal payments over 50 or 26 or less weeks (For 4th loan 18 months or less)		Members pay their groups. Groups pay WEDCO. Groups use administration to enforce payment.
Restrictions on loan use	Loans for existing business.	Must be for business use	Loans must be invested in existing business not for start-ups.		Loans for existing business.
Restrictions on use of savings withdrawals	N.A.	N.A.	None. Group holds the savings fund in bank accounts. It can withdraw the interest earned on that account (Variable).		20% equity deposit cannot be withdrawn till loan cleared.
Savings account opening procedures	N.A.	Have to open a savings account at a bank to join KWFT.	Compulsory savings required, from Kshs 50 per week on loan 1 to Kshs. 150 per week on		N.A.

KENYA	KREP	KWFT	NCCK / SBDO	PRIDE	WEDCO
			loan 5.		
Savings account access conditions	N.A.	Access only possible on exit. Rarely savings on top of guarantee level can be withdrawn if an emergency.	Savings only accessible through exit.		Savings in excess of prescribed weekly rate can be withdrawn.
Main donors and other sources of funds.	DFID, Ford Foundation, USAID	Savings only accessible through exit.	****		DFID only .
Intermediation.			****		

APPENDIX 3B: Tanzanian MFIs Studied: Matrix of Main Characteristics

TANZANIA	SEDA	PRIDE	PTF
Institutional Status	NGO. Now independent of but linked to World Vision, their founder	Company limited by guarantee (once considered becoming a bank: ties with Pride Africa of Nairobi)	Registered NGO
Target group of clients	Productive poor (and mainly women) micro enterprise owners	Micro and small enterprise owners	Unemployed poor women and youths with existing micro businesses, rural as well as urban
Year started	Registered 1996; operations October 1995	Registered 1993; operations 1994	NGO registration 1988; operations 1989
Institutional model	'Community Banking' (modified SHG model similar to Proshika's)	Grameen-type solidarity group; weekly meetings at PRIDE premises	Grameen-type solidarity group; weekly meetings in the village or peri-urban settlement
Staff numbers	34 (3/99), of whom 12 are Credit Officers	165 (4/99), of whom 80 are credit officers	25 (4/99) of whom 17 are credit officers
Current number of clients (or members)	4,500 (3/99) in 3 branches	28,750 (4/99)	4,700 (3/99)
Current number	3,000 approx	21,500	Approx. 4,200 (3/99)

TANZANIA	SEDA	PRIDE	PTF
of borrowers			
Current number of savers	4,500 (but SEDA doesn't collect or hold these savings)	28,750 – all compulsory savers	4,700 (3/99)
Ratio loan officers to clients, to savers, to borrowers	1:375 officers to clients and savers 1:250 officers to borrowers	1:359 officers to clients and savers 1:268 officers to borrowers	1:276 officers to clients and savers 1:247 officers to borrowers
Value of savings held	$22,985 (owned and held by members)	1.4 bn shillings (4/99) = $1.97 m (compulsory savings only)	29.4 m shillings (3/99) = $42,000, mostly compulsory
Value of loans out-standing	$415,127 (3/99)	1.5 bn shillings (4/99) = $2.11 m	$340,000
Level of self-sufficiency	45% 'operational self-sufficiency'	60% of operational coat	81% of costs covered by income in last quarter
Profit/loss last accounts period	Not available: loss	Loss of $356,750 in six months to June 1998	Loss of $8,400 in quarter ending March 1999
Drop-outs rates with years	Estimated approx 5% cumulative – there are definition problems	Cumulative over 50% over five years	Not tracked; maybe 24% per loan cycle (average 8 months) in urban area, less in villages
Arrears rate	12% at month end	Zero	Less than 1%
Interest rates on loans	30% flat plus 3% disbursement fee	30% p.a. flat plus disbursement fee of 1% of face value (second loan onwards); compulsory savings of $1.40 a week	30% p.a. flat plus disbursement fee of 5% of face value: compulsory savings of 5% of face value paid during loan
Interest rates paid to savers	None: Bank pays bank rates to member-held savings	10% of final value of compulsory savings paid on leaving scheme provided at least 12 months have elapsed and that the exit was voluntary (less than 50% of exits are voluntary) and provided that no compulsory savings were ever used to repay loans	10% of final value of compulsory savings paid on leaving scheme provided at least 12 months have elapsed and provided that no compulsory savings were ever used to repay loans of others
Loan application procedures	Group must be running a ROSCA and have completed training. Each member's loan application must be approved by group. Group then	Form a five person group: undergo eight weeks training: fill up form: undergo inspection of business by MEC (a group of groups): appear before MEC committee	Form a five person group: undergo seven days training (2 hrs a day): fill up form: get acceptance by Centre (a group of groups):

TANZANIA	SEDA	PRIDE	PTF
	makes a bulk application to SEDA.	and obtain approval	
Loan disbursement procedure	By cheque as a bulk loan to group., first loan not more than equivalent of 150,000 shillings per member, rising by 50,000 steps to 600,000.	Solidarity group members receive loans in a set order; loans are sized according to a fixed formula: loans issued by cheque from HQ within one week of MEC approval being granted (cheque can be open if there are problems with banking)	Where possible, by cheque to bank, other by cash at meeting: members get simultaneous loans at start of cycle (but pre-payment mean cycles get out of sync after a while)
Loan repayment procedure	By cheque each month or each week from group to SEDA bank account: COs don't touch money.	Weekly, with interest and compulsory savings, at Pride premises: no arrears allowed (all payments cleared in cash before members can leave the premises): number of weeks rises from 25 (first loan) to 40 (second) to 50 (subsequent)	Weekly, with interest and compulsory savings, at the village or peri urban settlement: no arrears allowed (all payments cleared in cash before members can leave the meeting): number of weeks rises from 26 (first loan) to 32 (second) to 52 (subsequent)
Restrictions on loan use	For existing businesses only (but it's hard to check and there is much diversion)	For existing businesses only. Businesses are checked but loan use isn't: management is aware of much diversion	For existing businesses only. Businesses are checked but loan use isn't: management is aware of much diversion
Restrictions on use of savings withdrawals	None	None (but see below)	None
Savings account opening procedures	Groups open it at a bank after making a Constitution and bye-laws	Part of membership application procedure.	Part of membership application procedure.
Savings account access conditions	On exit only, after all SEDA loans are cleared (SEDA is a signatory to group-owned bank accounts)	Savings are held as security against loans and no withdrawals are allowed until exit.	Savings are held as security against loans and no withdrawals are allowed until exit. Some voluntary savings as well.
Main donors and other sources of funds.	Grants from World Vision; USAID; Ford; DFID (for Mwanza branch)	Grants from NORAD for operations and for lending (some USAID grants go via Pride Africa)	Grants from Ford, ADF, Tanzanian-Swiss Trust Fund; loans from NIGP, Gatsby, Grameen Trust
Intermediation.	None (SEDA doesn't hold member savings). Some groups may intermediate their own savings.	Unlimited lending of the compulsory savings.	In past yes; now prefers to bank the savings and will negotiate for loans against these savings

APPENDIX 3C: Ugandan MFIs Studied: Matrix of Main Characteristics

UGANDA	Centenary	PRIDE	FOCCAS	Faulu	FINCA
Institutional Status	Formal bank	NGO (once tried to become a bank)	NGO	NGO owned by Food for the Hungry. In the process of becoming a limited liability company.	NGO
Target group of clients	Total adult population	Micro and small enterprise owners	Female micro and small enterprise owners	Micro and small enterprise owners	Female micro and small enterprise owners
Year started	1983	1996	1996	1996.	1992
Institutional model	Individual savings and loan accounts; transactions at the bank	Grameen-type solidarity group; weekly meetings at PRIDE premises	Village Bank type solidarity group; weekly meetings near the clients' businesses	Grameen-type solidarity group; weekly meetings near the clients' businesses	Village Bank type solidarity group; weekly meetings near the clients' businesses
Staff numbers	85 credit officers (4/99)	125 (4/99) also 15 trainees	36 growing to 41 (4/99)	30 of which 17 are credit officers	98 staff of which 50 credit officers (4/99)
Current number of clients (or members)	110,000, growing at 200 a day	Approx. 20,000 (up from 5,800 in 1/98)	7,616 members end March 1999.	3,950 End of February.	Approx. 17,000
Current number of borrowers	11,000	Approx. 14000	7,170 end of March 1999.	2,370 which is 60% of the total number of clients.	16,600
Current number of savers	110,00 of which most are savings a/c holders with some fixed deposit a/c holder	Approx. 20,000 (all of them are compulsory savers and some also save voluntarily)	0 (members make compulsory and some voluntary savings held by themselves)	All the 3,950 clients are savers.	0 (members make compulsory and some voluntary savings held by themselves)
Ratio credit officers to clients, to savers, to borrowers	An average of 1294 clients for one credit officer. And 129 borrowers per credit officer.	An average of 160 clients for every one staff.	An average of 211 clients for every staff employed by FOCCAS.	An average of 131 clients for every one staff and 140 borrowers for every credit officer.	An average of 173 clients for each staff employed and a ratio of 340 clients per credit officer.

UGANDA	Centenary	PRIDE	FOCCAS	Faulu	FINCA
Value of savings held	22bn-(58% in savings A/C, 30% in current, 1.5bn in fixed deposit.	1.4 bn in the loan insurance or compulsory insurance funds.	None (89.4 million held in bank accounts controlled by the communities them selves.) End March 1999	387million as loan security fund held by Faulu.	None (Group members hold their savings in their own group bank accounts; However by arrangement with the bank FINCA attempts to control withdraw from this account).
Value of loans out-standing	13bn	2.2 bn (End 1998)	476million (End Feb 1999).	487 million end of April 1999.	1.5bn(End March 1999)
Level of self-sufficiency	733 million profit in 1998, representing a 27% return on equity after removing subsidies.	They aim to be sustainable by the end of 2000.	60% operational self sufficiency end Dec 1998 (Down from 93% because of recent rapid expansion)	61% operational self-sufficiency in 1998.	81% operational self-sufficiency at end March 1999.
Profit/loss last accounts period	See above.	Accts still being audited.	Not obtained.	Not obtained.	A net surplus of $230,000 in 1998.
Drop-outs rates with years	Not calculated: account closures and inactive accounts said to be low.	On average this was 12.4% during 1998.	5% of members are either not using the current cycle or have said they will not use the next cycle.	The drop-out rate was 25% in 1997 and reduced to 17% in 1998.	Approximately 5% per month and rising. Note FINCA counts as drop-outs members who are merely sitting out during a loan cycle.
Reported arrears rate	Approx. 5%(Was 37.5% in 1994).	Portfolio at risk 0.5% one day past due.	Portfolio at risk, end Feb 1999, 5.8% (one day past due)	10% as at the end of April.	0%, they have 100% on time repayment.
Interest rates on loans	22% APR + 2% disbursement fee + 2% per month (declining balance)- Monitoring fee (declines with repeat loans)	30% per annum.	3% per month flat (i.e. 60-70% APR + compulsory savings).	3% per month flat (i.e. 60-70% APR + compulsory savings).	3% per month flat (i.e. 60-70% APR + compulsory savings).

UGANDA	Centenary	PRIDE	FOCCAS	Faulu	FINCA
Interest rates paid to savers	2% APR on savings accounts, 6.5% on fixed deposit.	None.	Groups obtain bank interest on their savings accounts.	Groups obtain bank interest on their savings accounts.	Groups obtain bank interest on their savings accounts.
Loan application procedures	Open a savings account: Complete application form: Undergo a loan appraisal: wait for loan committee approval.	Form a five person group: Get nine other groups of five; Under go six weeks training: Register it with the local authority: Register it as part of a PRIDE group: Compulsory savings for several weeks: Complete application form and provide proof of business.	Similar to FINCA.	Form a five person group: Under go two weeks training; Continue saving for the next six weeks; Register it as part of a Faulu group: Compulsory savings for the eight weeks equivalent to 1% of required loan: Complete application form and provide proof of business.	Form a “Village Bank” of at least 30 people comprising sub-groups of 5. Undergo six weeks of training. Compulsory savings for several weeks: Complete application form and provide proof of business.
Loan disbursement procedure	Bank transfer into client loan account.	Solidarity group members receive loans in a set order; maximum loans are sized according to a fixed formula.	All loans are issued at the same time in cycles – size according to a fixed formula: increasing each loan by 50%.	Solidarity group members receive loans in a set order; Loan sizes are flexible up to a maximum amount per given loan cycle.	All loans are issued at the same time in cycles – size according to a fixed formula: savings plus base loan..
Loan repayment procedure	Varies Mostly by two or three instalments over a six to eight months term: Some end of term balloon repayments.	25-50-week cycle of fixed equal weekly instalments depending on cycle and loan size.	Loans term similar to FINCA. FOCCAS field staffs do not handle money- repayments made through bank transfers.	First two loans have a 16 weeks repayment period: third and subsequent loans between six and nine months; field staffs do not handle money- repayments made through bank transfers.	16-week cycle of fixed equal weekly instalments.
Restrictions on loan use	Must be for commercial or agricultural uses.	For existing businesses only.	For existing businesses only.	Loans are given to existing businesses and start-up businesses of up to one member per group	For existing businesses only.

UGANDA	Centenary	PRIDE	FOCCAS	Faulu	FINCA
				of five if that subroup agrees to cross guarantee the new start-up business.	
Restrictions on use of savings withdrawals	None.	Savings are held as security against loans.	Savings are held as security against loans. However, clients can withdraw down to 5% of the outstanding loan. (But FOCCAS does not have a strong system for enforcing this)	Savings are held as security against loans. Faulu has now introduced weekly withdrawals of voluntary savings based on performance of the group of five..	Savings are held as security against loans.
Savings account opening procedures	Conventional bank procedures requiring application forms , identification and referees.	Part of membership application procedure.	Part of membership application procedure.	Part of membership application procedure.	Part of membership application procedure.
Savings account access conditions	Unlimited access up to the minimum required balance of Shs. 10,000/= for savings account holders.	Savings can be withdrawn only if all loans of all members of the solidarity group have been completely repaid	Same as FINCA except that FOCCAS has no arrangement with banks to restrict withdraws.	Unlimited access unless group has arrears.	Savings can be withdrawn only if all loans of all members of the solidarity group have been completely repaid
Main donors and other sources of funds.	Savings, Investors (Catholic church owns 70% of shares), retained profits.	**** 95% of funds are from grants.	Grants from UNDP, UNICEF, and USAID via PRESTO and via FFHC, FFHC. Soft loans from social investors in USA. Loans from EDF and a line of credit from the Co-op bank.	USAID, Compassion Canada, CIDA.	USAID, USAID via PRESTO, EDF soft loan, TA from Austrians.
Intermediation.	Full intermediary institution.	Lends out 30% of its loan insurance funds.	None.	None.	None.

APPENDIX 4

Methods Used

The research team used a variety of quantitative and qualitative methods to collect data.

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 Appraisal techniques including:

⇒ Seasonality Calendars
⇒ Wealth ranking
⇒ Lifecycle-lump sum analysis
⇒ Money management systems matrixes

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.

A total of around 1400 people were interviewed in about 200 different sessions. Roughly 1000 were MFI clients or drop-outs, 200 were non-clients (mainly from low income and poor households) and 200 were MFI employees.

APPENDIX 5

Cumulative Retention and Exits by Loan Cycle and Loan Size

PRIDE (Tanzania)

Loan No.	Nil	Loan 1	Loan 2	Loan 3	Loan 4	Loan 5	Loan 6	Total
No. of clients	50,797	38,828	18,982	6,658	735	111	12	50,797
Exits	10,438	11,404	2,970	1,040	74	3	1	25,930
Retention %	79.5	70.6	84.4	84.4	89.9	97.3	91.7	-
Total Exit %	40.3	44.0	11.5	4.0	0.2	0	0	100

***Source**: PRIDE office records*

APPENDIX 6

Characteristics of 30 Drop-outs from Kenyan MFIs

REASON FOR DROP-OUT	SEX	BUSINESS CHARACTERISTICS	ASSESSED INCOME LEVEL[2]
1. Business Failure	F	Butchery, single woman	Low
2. Poor Attendance at meetings	M	Headmaster, wife running business	Medium
3. Change of Programme Policy	M	Well off, owner of a hardware shop	Upper
4. Poor Business Performance	F	Hair salon	Low
5. Poor attendance at meetings	M	Good Transport Business	Upper
6. Poor attendance at meetings	M	Bar Business	Upper
7. Poor payment record	M	Milk Bar	Low
8. No reason	M	Sell clothes	Medium
9. Illness	M	n/k	n/k
10. Illness	M	n/k	n/k
11. Business collapsed	M	n/k	Low
12. Programme rules not suitable	M	Restaurant, doing well	Upper
13. Business closed	M	Family business, poor management	Upper
14. Unwilling to pay Municipal Licence	F	Market Trader	Low
15. Employed-forced out	F	No Business	Medium
16. Employed-forced out	F	No Business	Medium
17. Migration	F	n/k	n/k
18. Business failure	F	n/k	n/k
19. Meetings far away	F	Hardware, small child, no transport	Medium
20. Fear of debt	M	-	-
21. Unable to repay	F	Salon	Low
22. Unable to repay	F	Market sales Person	Low
23. No time for meetings	M	Business ongoing	Medium/Upper
24. Voluntary	M	Barber, business ongoing	Medium/Upper
25. Illness	n/k	n/k	n/k
26. Migration	n/k	n/k	n/k
27. Migration	F	n/k	n/k
28. Voluntary	F	n/k	n/k
29. Illness	F	n/k	n/k
30. Business failure	M	Retail shop, many problems	Low

Source: *Kashangaki (1999*

[2] Please note that these income levels are derived from our assessment of the business premises and social characteristics of the dropouts and our knowledge of the economy. They are to be used as a guide to the dropouts level of income compared to 'average' members of the MFIs concerned.