

# TECHNICAL NOTE 1 *revised*

## ESTIMATING CLIENT EXIT RATE



Micro-Credit Ratings International Limited, Gurgaon, India

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The purpose of this technical note is to reach a practical definition of client drop-outs in microfinance and to propose a working formula to calculate the drop-out rate. The focus is on simplicity. The note comments on various methods for calculating client drop-out and arrives at the formula adopted by M-CRIL.

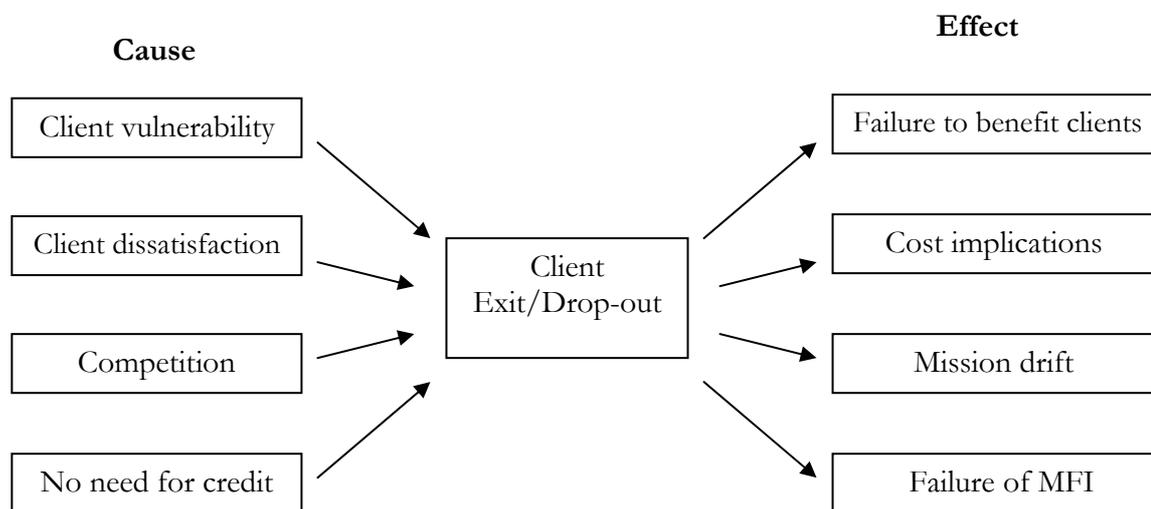
We are updating this note

**Micro-Credit Ratings International Limited**

*M-CRIL is an international rural finance consultancy providing specialised services in rating, monitoring, evaluation and sectoral research services for the microfinance industry.*

### Context

M-CRIL's experience with microfinance rating has shown that client exit (or drop-out) is a major factor affecting the sustainability and growth of MFIs. The rate is a reflection of the relationship between the MFI and its single most important resource, its clients. Monitoring the trend in the exit rate can yield valuable insights on an MFI's performance and credibility. Drop-outs can be a cause as well as an effect of factors internal and external to the organisation.



Analysing the exit rate – and following up with research into reasons for drop-out – is an important part of market research for microfinance. Data can be analysed to assess dropouts by branch, by client category, by loan cycle, or by other client characteristics that may be captured in the MIS. This represents a key component of effective social performance management by a microfinance institution. (Go to [www.imp-act.org](http://www.imp-act.org) for more on social performance management in microfinance).

Nevertheless, there is quite an array of definitions of drop-out, and ways to calculate the rate of exit.

The purpose of this note is to suggest a working definition of the phenomenon of client drop-out which is operationally convenient for MFIs. The note proposes a formula to calculate the drop-out rate from the simple records that MFIs generally maintain. It is intended as a contribution towards

a standardised approach for reporting. For the purpose of reaching a definition and to derive a working formula, various definitions and calculation methods are reviewed here.

## Definitions of client exit or drop-out

Here we use the term ‘drop-out’ whilst recognizing that not all those who exit a programme are necessary ‘drop-out’. There may be ‘fly-outs’ – those who perhaps graduate into formal finance, as well as those who may have benefited and no longer need microfinance services.

There are various ways in which ‘drop-outs’ have been defined by researchers and practitioners. Some of these definitions are noted below.

**Withdrawal of compulsory savings** For organisations accepting compulsory savings, a client can be termed as dropped out, once she has completely withdrawn her compulsory savings from the organisation. Compulsory savings generally signify association with the organisation and its withdrawal marks the dissociation of the client from the MFI.

*This definition has the advantage of simplicity and availability of data. However, in practice clients may stop attending meetings and may or may not be in default on an MFI loan, but who have not been allowed to withdraw their savings balances. They may themselves not be aware of their right to do so. Such clients would not be called drop-outs based on this definition. Another inherent limitation of this definition is its applicability. The definition covers only organisations accepting deposits and hence lacks universality.*

**Attendance based** A client can be termed as dropped out if she does not attend the compulsory meetings of MFI clients for a specified period of time.

*This method is again simple and the data could be obtained from group attendance registers, however, it may not prove effective in areas where members due to their jobs, the compulsions of daily wage earning or temporary migration are unable to attend meetings but are regular in depositing repayments or voluntary savings.*

**CGAP definition** A dropout is defined as a client that did not take a follow on loan within the next ‘x’ number of days.

*This definition is relevant in MFIs which only provide credit. However, microfinance as it exists today, has expanded well beyond credit. Clients may not take a repeat loans for a significant period of time but may be accessing other financial services offered by the MFI. In which case, such clients cannot be called drop-outs.*

**Prizma definition** A drop-out is a person who has repaid any type of loan but has not taken any new loan during the next 90 days. An analysis of MFI historical drop-out data indicates that 90 days is the point at which, almost all clients intending to drop-out will have already done so.

*Again, as with CGAP’s, this definition considers only credit transactions.*

**Waterfield definition: Decision based retention** This definition focuses on retention in terms of clients who had a decision point during the period and remained. A dropout then is a client who had a decision point and decided not to remain.

*This method has the conceptual advantage of focusing on those who actually face a choice during the period. Having a decision point is taken to refer to being at the end of a loan cycle. In theory it could be adapted to include decision points related to other services, though these may be difficult to define.*

**M-CRIL's definition** After considering various ways of defining drop-outs, M-CRIL has attempted to arrive at a simple definition that reflects the field situation based on information obtained from the records maintained by many MFIs. M-CRIL proposes the following definition

**“A drop-out is any client who has had no significant transaction with the MFI for the last 6 months”**

The transaction/engagement here would mean savings, loan repayment, taking loans and attending meetings. Often, small amounts of money are lying in the savings accounts of members without any activity in the account for many years. Holders of such dormant accounts would also qualify as drop-outs. This definition includes, all dissociated members irrespective of their reasons for dissociation and, hence, includes reasons like death and migration.

### Drop-out rate

Just as opinions on the definition of client drop-out are divided, there are differences in the adoption of a formula for the calculation of the drop-out rate. The following are M-CRIL's comments on these formulae

#### **Accion formula (the 'old' formula)**

$$1 \quad D_r = \frac{X_0 + NC - X_1}{X_0}$$

*This formula has the advantage of being simple and can be calculated even with a simple MIS. The formula is conservative in approach as it calculates the rate from the beginning of the year base. However, the formula has the major limitation that it cannot be used for newly started MFIs, where  $X_0$  would be 0. Even for older MFIs, the formula may not provide a true picture for organisations in a high growth phase with large numbers of clients being added and dropping out in a particular year.*

#### **CGAP formula**

$$2 \quad D_r = 1 - \frac{FS}{TS}$$

Adjusted

$$D_r = 1 - \frac{FS \text{ (within } \gamma \text{ days)}}{TS}$$

*This formula is complicated and requires a strong MIS. The formula is also narrow in approach as it treats only those individuals taking repeat loans as clients and the rest as drop-outs. It is quite common for MFIs to have clients who may not take loans but still be saving with the organisation and, hence, should not be included in drop-out calculations.*

$$3 \quad D_r = \frac{X_0 + NC - X_1}{\text{Average } (X_0 \dots X_1)}$$

*This formula tries to cover drop-outs even among newly recruited members and thereby gives a more representative picture than the Accion formula – based on the average of clients during the period (the denominator is the number of clients the MFI is working with at a given point in time and does not cover all the clients the MFI has worked with during the period).*

### Waterfield formula

$$4 \quad D_r = 1 - \frac{X_1 - C_s}{X_0 + NC - C_s}$$

*This formula seeks to focus on clients with the same (continuing loan) which could be interesting if an MFI can generate this information in its MIS.*

### M-CRIL' s adopted formula<sup>1</sup>

$$4 \quad D_r = \frac{X_0 + NC - X_1}{X_0 + NC}$$

*This formula calculates drop-outs as a proportion of all the clients that MFI has come across during the period. It does not take clients at the beginning of the period as the base, as drop-outs could occur from new as well as old clients. The formula has the limitation that it calculates drop-outs from the highest possible denominator and hence would tend to be a liberal figure from the MFI's perspective. However, observing the trend of drop-outs across various organisations, M-CRIL's perspective is that the MFI has made efforts to serve all the clients it has come across during the period – those that drop out even before the start of a loan cycle have also received some MFI attention. Therefore, they should be included in both the numerator and the denominator of the drop-out rate calculation. The number of clients here is determined by M-CRIL's definition of drop-outs as set out in the previous section.*

#### Legend

$D_r$	–	Drop out rate
$X_0$	–	Total number of clients at the beginning of the period
$X_1$	–	Total number of clients at the end of the period
NC	–	New clients – all those who joined during the period
FS	–	Number of repeat loans made during the reference period
TS	–	Number of repaid loans (closed services) in the reference period
FS <sub>Y</sub>	–	number of follow on loans made within Y days since the last repayment during the reference period
$C_s$	–	Clients with same (continuing) loan during the period

<sup>1</sup> This formula is adapted from the Schreiner Formula referred to in Richard Rosenberg. "Talking about Performance Ratios" in the *MicroBanking Bulletin*, April 2001.