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, as most MFIs do not maintain complex databases of information on client status. The note comments on various methods for calculating client drop-out and arrives at the formula adopted by M-CRIL.

**Context**

M-CRIL’s experience with microfinance rating over the past 6.5 years has shown that the client drop-out rate 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 drop-out rate could yield valuable insights on an MFI’s performance and credibility, as drop-outs could be a cause as well as an effect of factors internal and external to the organisation.

The Microfinance Centre, based in Poland, has undertaken detailed work on the importance of client drop-outs, the definition of drop-outs and the calculation of the drop-out rate. However, most of this work is based on social indicators and, hence, generally differentiates drop-outs as voluntary-satisfied, voluntary-dissatisfied and forced out. As the work is focused on determining the reasons for the drop-outs or is exploratory in nature, such differentiation is important. From an analytical perspective such segregation is important. It is known that drop-outs could vary from organisation to organisation due to variations in geographical, institutional and operational context making it difficult to compare across organisations. It may also occur due to factors such as migration that are external to the organization and, hence, sometimes may not necessarily reflect the MFI’s effectiveness or efficiency.

The purpose of this note is to suggest a working definition of the phenomenon of client drop-out which has field relevance and is operationally convenient for MFIs rather than based on detailed research and needing elaborate methodologies to establish and measure. The note proposes a formula to calculate the drop-out rate from the simple records that MFIs generally maintain. For the purpose of reaching a definition and to derive a working formula, various definitions and calculation methods have been discussed in this note.

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**Cause**

- Client dissatisfaction
- Competition
- No need for credit

**Effect**

- Cost implications
- Mission drift
- Failure of MFI

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Definitions of client drop-out

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

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 seems to limit the scope of microfinance only to providing credit. However, microfinance as it exists today, has expanded well beyond credit. Many clients may not take repeat loans for a significant period of time but may be active in using other financial services offered by the MFI. 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 historical drop-out data by Prizma indicates that 90 days is the point at which, almost all clients intending to drop-out will have already done so. Drop-out here also includes those who have been expelled by the organisation or by other members.

The Prizma definition suffers from the same limitation as CGAP’s. While it takes into consideration credit transactions of the client it neglects other forms of transactions that the client may have with the MFI.
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 most MFIs. M-CRIL proposes the following definition

“A drop-out is any client who has had no 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 are on the definition of client drop-out are divided, there are similar 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

\[
1 \quad Dr = \frac{X_0 + NC - X_1}{X_0}
\]

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

\[
2 \quad Dr = 1 - \frac{FS}{TS}
\]

Adjusted

\[
1 - \frac{FS \text{ (within } v \text{ days)}}{TS}
\]

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.
This formula tries to cover drop-outs even among newly recruited members and gives a more representative picture than the Accion formula. From the risk measurement perspective it may not be adequate as it makes calculations by taking the base as the monthly average of clients during the period which means 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.

M-CRIL’s adopted formula\(^2\)

\[
Dr = \frac{X_0 + NC - X_1}{X_0 + NC}
\]

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
- \(FS_Y\) – Number of follow on loans made within \(Y\) days since the last repayment during the reference period