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Drop-outs Among Selected Zambian Microfinance Institutions: Causes And Potential Impact On Product Design

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Executive Summary

Background

One of the biggest challenges in the provision of financial services to micro and small entrepreneurs is to design appropriate products reflecting an understanding of the reality of this market. This is not a challenge that has been met by most micro finance institutions (MFIs). The result is that clients are forced to accept products that in most instances do not answer to their needs, but on the other hand is the only product available. One of the results of this situation is the tendency of clients to exit programmes or services of MFIs after the initial engagement.

Members "dropping out" or leaving an MFI are costly to the organisation in many ways – in terms of investments in training and "social preparation", in terms of the opportunity costs of losing the older, more experienced members most likely to take larger loans. The surprisingly high dropout rates experienced by East African MFIs may be indicative of a mismatch between client attributes and conditions (overall market attributes) and product design and delivery. This may be due to many reasons, inter alia, the inflexible financial services MFIs provide to their clients, dissatisfaction with the quality of financial services being offered by the organisation or better services being offered by another MFIs.

Studies on the dropout problem in Zambia have indicated high dropout rates, some as high as 52 percent. A recent study on one of the best performing MFIs in the country found a dropout rate of 32 percent. These two studies confirm the existence of high dropout rates in Zambia.

Research Objective

The purpose of this study is ***to improve knowledge and understanding of why MFIs in Zambia suffer high levels of dropout (or turn-over) among their clients, and thus to facilitate MFIs' efforts to address this problem***.

Specifically the study will:

- Analyse the socio-economic characteristics of drop-outs;
- Review the reasons for drop-out amongst clients including those that have switched between MFIs;
- Examine reasons why poor people eligible to join MFIs in the areas where they are operating choose not to;
- 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.

Methodology

This study used qualitative research methods, in particular Focus Group Discussions ranging from Focus Group Discussions based on discussion guides to using Participatory Rapid Appraisal techniques with people who are clients, those that have exited and staff of the selected three MFIs. The researchers held discussions with the managements, credit officers, clients and ex-clients of CARE PULSE, Women Finance Co-operative of Zambia (WFCZ) and PRIDE Africa - Zambia. The study was conducted in a wide variety of settings, in Lusaka's planned and unplanned townships, in Kafue a small railway town and in Choma a small farming town. Permission was granted by all the MFIs to interact with staff and clients, and all three MFIs facilitated meetings and assisted in general with the research effort.

Summary of conclusions and recommendations

We asked focus group participants to define what they thought were the socio-economic classification of MFI clients, and specifically how they perceive the poverty levels of clients. From the various descriptions a classification emerged. MFI clients can be classified into three classes, namely; relatively better off, managing despite poverty and struggling with poverty. Dropouts came from all these classes, however per session (and thus per area) one could detect a difference. It was clear that although dropouts came from all three categories, most session results indicated dropouts from the struggling class. It seems that they are more inclined to reallocate loan funds to the purchasing of consumer items, presumably as a result of a limited resource base and a sizeable income expenditure gap. In the case of the relatively better-off clients it seems that they do not like working in groups particularly with people whom they consider to be of lower social status. Young people are particularly prone to dropout because they are more mobile and are doing business to pass the time while waiting for formal employment. We found clear gender differences; men are more likely to dropout because they do not like to work in groups. We further found a seasonal pattern to dropout with the highest incidence in the first two months of the year.

Although reasons for dropout may vary among clients and institutions, in this study we identified the following common reasons:

Delays in loan disbursement: Loan disbursement delays were frequently cited as a reason for dropping out, these delays adversely affect the liquidity of business, especially as clients begin paying the Loan Insurance Fund (LIF) before loan disbursement.

Reallocation of loan funds: This is reallocation of loan funds to purposes other than what was agreed. It was cited in all sessions we held. The perception of the clients is that they have a better view of the purpose for the loan and should therefore decide how they would like to apply it. The dropout arises where the loan is reallocated to consumption purposes and inadequate returns are realised in the business to service the loan.

Group liability: Good clients usually resent the application of joint liability when default occurs because they feel that they are being overburdened by debts of other people especially in a situation were an individual pledged some collateral besides the group liability. They also did not like the concept that their liability stretched beyond their immediate group.

Loan Insurance Fund: The discontent with LIF is mainly due to a misunderstanding between the clients and the MFIs. Clients perceive LIF as a savings facility and are unhappy that it is used to settle liabilities of other people, especially outside the immediate group.

Weekly repayment: The discipline that weekly repayment is supposed to promote is widely acknowledged by clients but the failure to take into account the cash flow of their businesses is what causes the discontent. The argument is that the loan product requirement and their business cash flows are not synchronised.

Loan Amount: Loan amounts for first and second loans are considered inadequate by clients, this has forced some clients to borrow from other sources to supplement, which ultimately complicates repayment obligations and leads to default and consequently dropping out, especially where loans have been reallocated to consumption use.

We interviewed micro entrepreneurs operating in markets that were serviced by MFIs but had decided not to join and we also asked the participants of the focus group discussions and PRA sessions what they thought were the reasons for those people eligible to join MFIs but choose not to. We received a variety of interesting responses ranging from superstition to misinformation by former clients. Some clients believed that MFI loans had magical powers that erodes ones capital, others were misinformed of the loan conditions by disgruntled former clients and some had correct information about loan conditions but felt the conditions were too demanding, especially the weekly repayments and meetings. These responses reflect the understanding of people of the systems of the MFIs. It further reflects on the clarity of the MFIs marketing message, and the reputation of the MFI in terms of the treatment of defaulters.

The focus group discussions and the PRA techniques generated information that confirmed the existence of people who join two or more MFIs at the same time. We were surprised to note that the practice was established to the extent that clients we met in the previous institution reappeared in another focus group discussion with clients of another institution. The motivation for dual membership was identified as a desire to increase capital base in view of the small loan amounts particularly, first and second loans. It was also to access other products, for example one of the clients we spotted in two institutions said she did so because the second institution offers a savings product. This is a clear indication of inadequate product attributes of the products. Thus clients have their own strategies to combine products across institutions to build a more acceptable product.

Recommendations

Loan Disbursement

Delays in loan disbursement is damaging the reputation of MFIs and negatively impacting on sustainability and growth. MFIs should avoid these delays. The delays that are due to lack of funds should be addressed by ensuring that loan processing (recruitment and training of clients) is done only when funds for lending are assured. Delays due to procedural and other administrative considerations can be minimised by streamlining the systems of the MFIs. In particular, repeat loan approvals should be streamlined to reflect the fact that these relate to clients of whom the institutions have some track record. It is clear that where institutions effected these changes a positive response was experienced.

Loan use reallocation

Diversion of loan funds to other uses such us school fees, health, consumption etc. could be an indication of opportunities for new products or weak cash flow assessment by the MFI to determine debt capacity. Possible ways of minimising loan reallocation include, offering demand driven products, careful selection of clients to prevent undesirable individuals access to loans, flexibility on loan use and better assessment of household repayment capacity. – it is in any case extremely difficult to monitor because money is fungible.

Group Liability (Group Guarantee)

Peer guarantee is a corner stone of the group lending methodology; it is assumed that group lending solves the problem of lack of information by the MFIs on the clients and that it lowers transaction costs. Unfortunately the majority of respondents in this study did not like it. They do not like paying for others. To reinforce the group liability, MFIs need to improve client selection and group formation. MFIs must be forthright about the risks associated with peer guarantees. In addition flexibility in reinforcement would be useful, for example if a defaulter had pledged collateral, priority should be to collect the collateral before attaching the group LIF. In order to minimise costs associated with collection and liquidation, the process should be handled by the group within a given timeframe failure to which the group LIF would be attached. The merit in this approach is that clients are offered an opportunity to avoid paying for others. As clients move to higher cycles, more information is obtained on the clients; therefore there should be less emphasis on joint liability.

Loan Insurance Fund (LIF)

The problem with the LIF is that of perception, clients perceive the LIF as a form of a savings account and not as an insurance fund that could be attached in case of a default in the group. This mistaken view is largely due to the absence of savings products and also confirms the demand for such services. MFIs have two possible strategies. First they could improve the training and information on the functioning of the LIF. Secondly, MFIs could develop separate saving and insurance products. The insurance product could cover group defaults and would be a pure insurance product, thus it will not be paid out. The savings product will therefore also be a pure savings product and this will decrease the confusion. The latter will most definitely address the problem of the desired availability of savings products. MFIs not licensed to take deposits can achieve this through linkages/partnerships to licensed deposit taking financial institutions.

Weekly Repayment

The weekly repayment schedule fails to take into account the cash flow limitations of most micro businesses and tends to prescribe the type of businesses that can benefit. For example most carpenters sell on credit of 30 days or more; it is not practical to expect such clients to service loans on weekly basis. Cross border traders are another category of clients who find difficulties to comply with the weekly repayments, especially in the absence of a grace period. The nature of cross border trading requires travel to another country. For example, most cross border traders going to South Africa go by road, a journey taking at least a day or more, that combined with the time it take to obtain the goods and complete the return journey basically takes care of the first week of the loan contract. Thus when in Zambia again the weekly instalment is due but they have not even sold the merchandise yet. MFIs should design repayment schedules that take into account the cash flow pattern of the business.

Loan Amount
The outcry on the inadequate loan size of the first and second loans is a genuine concern because of the rapid depreciation of the Kwacha because of inflation. MFIs should plan loan sizes in real terms, which would imply regular adjustments to the loan amounts to reflect the level of inflation. Quicker loan disbursement and more streamlined systems would most probably be the best solution for this problem. Also, it is important to get the clients to lodge a final application after the six-week training period (rather than before), as this will accommodate all price changes and loan sizes of applications. On the other hand clients should understand the importance of establishing a credit history before acquiring higher loan amounts.

Customer Service
During the course of this study a substantial number of clients said that they were not happy with the customer services they were receiving, in particular they felt that credit officers were leaving too many issues to be sorted out by group executives. We are aware that clients can and do generalize about an entire organization based on one bad interaction. Although it is a methodological choice, to keep staff out of the clients' problems, guidance from credit officers would encourage group executives. Moreover, credit officers must see clients as customers who are paying for the services and give due respect. Staff training in this aspect and a corporate methodological shift is desirable and highly recommended.

Multiple Borrowing
We found evidence of multiple borrowing; at two occasions we met clients whom we had interviewed in the previous institution. There is an urgent need for MFIs to develop a mechanism of identifying such clients. This provides a good opportunity for co-operation between MFIs that may lead to the business opportunity of running a credit bureau once the market has enough volume. We did note that some of the MFIs are already exchanging information on default clients. This exchange of information is intended to enhance better decision making in the process of assessing debt capacity and not necessarily stopping multiple borrowing.

Potential Impact on Product Design
These findings are pointers to the mismatch between market expectations and product design and delivery. The findings therefore, suggest a fundamental review of the product design to make the various products being offered by MFIs in Zambia client responsive. For example this study shows that the first quarter of the year is usually bad for business, possible action would be to design a loan product that offers a 'rest' period during the first quarter of the year. The overall message is that the products on offer are inflexible and not client responsive and are undermining the growth and sustainability of the MFIs in Zambia. Another important aspect that needs attention is the quality of communication, in terms of the marketing message, the communication with clients and the communication with staff.

We did not engage in a review of the sustainability of the MFIs in this study, however we question the potential for sustainability if MFIs are facing such a high rate of client attrition. We are not surprised by these findings because studies in East Africa found similar situations where similar financial methodologies are followed.

Thus our findings correlate clearly with the findings of many other researchers in East Africa that studied similar systems. It is clear from these combined findings that the system of group lending as applied by the institutions studied is in essence flawed in the context of the reality of study areas and clients. The many similar findings with small country specific issues lead to the conclusion that the system as such should also be reconsidered. We do not give attention to this notion in our recommendations, as we did not investigate the complete group based system in the whole of East Africa. We are however convinced that the similar findings are enough justification to question this system.

We are aware that some institutions have experimented with offering two loan cycles on a group basis during which clients establish a credit history. The third loan becomes individualized. This is the kind of reconsideration approach we are advocating. We acknowledge the value of group lending in addressing the information asymmetry problem and the collateral issues.

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ACRONYMS AND ABBREVIATIONS

AFCAP	-	Microfinance Capacity Building Programme in Africa
AMIZ	-	Association of Micro Finance Institutions in Zambia
CARE	-	Caring and Activities for Relief Emergencies
CETZAM	-	Christian Enterprise of Zambia
CGAP	-	Consultative Group to Assist the Poor
CHILIMBA	-	A local term for Rotating Savings and Credit Association(ROSCA)
DFID	-	Department For International Development
ECI	-	Ebony Consultancy Incorporation
EG	-	Enterprise Group
GDP	-	Gross Domestic Product
GRZ	-	Government of the Republic of Zambia
GULU	-	A group of 30 members
KALOBA	-	A local term for “Money lender”
LIF	-	Loan Insurance Fund
MBT	-	Micro Bankers Trust
MEC	-	Market Enterprise Committee
MFIs	-	Microfinance Institutions
NGO	-	Non governmental Organisation
ODA	-	Overseas Development Agency
PRA	-	Participatory Rapid Appraisal
PRIDE	-	Promotion of Rural Initiatives and Development Enterprises
PULSE	-	Peri-Urban Lusaka Small Enterprise Project
SANO	-	A group of 5 members
UNDP	-	United Nations Development Programme
UNV	-	United Nations Volunteers
WFCZ	-	Women Finance Co-operative Zambia
ZANACO	-	Zambia National Commercial Bank

1. Introduction and background

1.1 Background

Due to the low level of development of financial systems and markets in most African countries and the high reliance on self-employment as a livelihood strategy by most of the poor in these countries, access to financial services is important. Unfortunately a low proportion of entrepreneurs have access to financial services to further their business objectives. The institutions providing these services are mostly non-bank institutions and either non-government organisations, parastatals and self-help organisations.[2]

One of the biggest challenges in the provision of financial services to micro and small entrepreneurs is to design appropriate products reflecting an understanding of the reality of this market. This is not a challenge that has been met by most micro finance institutions (MFIs). The result is that clients are forced to accept products that in most instances do not answer to their needs, but on the other hand is the only product available. One of the results of this situation is the tendency of clients to exit programmes or services of MFIs after the initial engagement, referred to as dropouts.

Microfinance institutions in East and Southern Africa report high dropout figures (see Wright, 2000). This phenomenon also occurs in Zambia as reported by several institutions (Masumbu, 2000; Copestake, 1998). Although institutions in Zambia (notably Pulse) has researched this problem internally, and subsequently adjusted their product line, the high dropout rates continued. This causes high cost in client selection and systems and militates against the institutions reaching scale and sustainability. The question is why people are dropping out of the systems, and how to research this phenomenon.[3] This may provide us with more specific answers than the earlier research. Based on the success achieved with studies of dropouts in Uganda and elsewhere, it has been decided to use qualitative research methods to study the dropout problem and influence product design and refinement.

1.2 Research objective

Members "dropping-out" or leaving an MFI are costly to the organisation in many ways – in terms of investments in training and "social preparation", in terms of the opportunity costs of losing the older, more experienced members most likely to take larger loans (MicroSave, 2001). The surprisingly high dropout rates experienced by East African MFIs may be indicative of a mismatch between client attributes and conditions (overall market attributes) and product design and delivery (Wright, 2001). This may be due to many reasons (MicroSave, 2001), inter alia, the inflexible financial services many MFIs provide to their clients, dissatisfaction with the quality of financial services being offered by the organisation or better services being offered by other MFIs.

Drop Outs in East Africa[4]

In East Africa the rate of client drop out ranges between 25% and 60% per annum. Clearly this represents a substantial barrier to achieving operational sustainability. When an organisation is losing over a quarter of the clients it serves every year, it is "running hard to stand still". In the words of Hulme, "client exit is a significant problem for MFIs. It increases their cost structure, discourages other clients and reduces prospects for sustainability" (1999). Ironically, many of the clients are driven out not only by the inappropriate design of the MFIs' loan products but also by the unwillingness of MFIs to recognize that (particularly in rural areas) there are seasons when not credit but savings services are required. Thus clients are forced either to take a loan (and try against the odds to service it despite the low season) or to leave the MFIs' programme. And all the while, their need for savings services is simply unmet and ignored by the MFIs.

[2] With a few notable exceptions in countries like Namibia and South Africa where private sector institutions and commercial banks provide the bulk of the micro finance services, however focused on consumer finance rather than the financing of entrepreneurs.
[3] In this report dropouts are defined as former clients of an MFI including those 'resting'. However, excludes those not borrowing but continuing to save and participate in meetings.
[4] As cited in ***MicroSave*** (2001). Market Research and Client-Responsive Product Development.

The purpose of this study is ***to improve knowledge and understanding of why MFIs in Zambia suffer high levels of dropout (or turn-over) among their clients, and thus to facilitate MFIs' efforts to address this problem***.

Specifically the study will:

- Analyse the socio-economic characteristics of drop-outs;
- Review the reasons for drop-out amongst clients including those that have switched between MFIs;
- Examine reasons why poor people eligible to join MFIs in the areas where they are operating choose not to;
- 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.

1.3 Outline of the report

In the first section we have provided background to the research problem and stated the research problem. In section two we provide the context within which the study took place, the reality of micro finance in Zambia and the specific situation with respect to the MFIs studied.

Section three discusses the methodology used and the collection of information. Section four discusses the analysis and the results of the analysis. In section four we differentiate between reasons for dropouts due to problems the clients encounter in their businesses and problems due to the MFI product structuring and delivery.

We conclude with section five in which we summarise the findings and discuss the impact that the findings have on the refinement of current products. We also discuss our experience and views on the research methodology and attempt to identify relevant research areas for the future.

2. Context

2.1 Introduction

In this section we will provide the context within which the study took place. This will be presented on three levels, viz. the macro context, looking at the overall economy, the context of the micro finance sector, and the context of the specific firms studied.

2.2 The Zambian Macro-Economic Framework

The Zambian Government's current macro-economic policy focuses on the key tenets of the Structural Adjustment Programme intensively implemented since 1991. Notwithstanding the existence of the Programme, Zambia has neither achieved a sound level of macro-economic stability, nor adequate economic growth even by developing country standards.

Though not as high as during the early 90s, the inflation rate (30% - December 2000) remains a major problem in attaining macro-economic stability. The GDP growth has fluctuated considerably over the past 8 years and has on the average not been high enough to stop the continued decline in real GDP per capita. In the few years when higher real GDP growth rates were achieved (1993 +6.8% and 1996 +6.4%) the single biggest contributor to growth was the agricultural sector. The high growth in agriculture came from export crops like cotton, fresh flowers and tobacco. Given the negatively changing weather patterns experienced over the past decade and in view of the limited irrigation infrastructure in the country, the sustainability of high agricultural growth rates is doubtful.

The debt stock of over US$6 billion remains a major constraint to growth and is unsustainable. With a debt-to-GDP ratio that is in excess of 100%, a present value of debt-to-export ratio close to 450% and a debt service-to-export ratio of nearly 30%, Zambia's debt burden far exceeds all the normative upper bounds for sustainability. The result is that adhering to the conditions imposed by the multilateral financial institutions entails a huge opportunity cost for the country in terms of lost development. Zambia's annual expenditure on debt servicing, for example, exceeds its total expenditure on social services.

Due to pressures resulting from recurrent expenditures, the Government's target for capital expenditures was rarely met. On the average, donors have financed 70% of public capital programmes. Formal sector employment declined over the past seven years and prospects for improvements in the near future are poor. Local industries are still operating at low levels of capacity utilisation. Further retrenchments are foreseen without adequate creation of new job opportunities. In export-based agriculture, some rise in the demand for non-skilled labour may be registered and income opportunities for smallholder producers improved, but there are no indications that the relative wages for labour - let alone the terms of trade between agriculture and industry - will improve.

2.3 The Microfinance Industry in Zambia

2.3.1 Introduction

The Microfinance sector in Zambia is characterised by its relative youth. The sector emerged in the middle of the 1990s. There are currently about 43 micro-finance institutions (MFIs) of which only about one third are currently active. This high rate of inactive MFIs is due to two factors, the easy of entry to this industry has attracted even people without the capacity to run a microfinance institution, institutions formed by such people do not last long and secondly the prospect of donor funding has been a major attraction in the formation of MFIs. But many of these MFIs have failed to secure donor funds and therefore remain inactive. About 23 MFIs are members of the Association of Micro-Finance Institutions in Zambia (AMIZ) established in January 1999. In addition, there is a wholesale micro-finance lending institution the Micro Bankers Trust (MBT) established in October 1996. Overall, the capacity of the Zambian micro-finance sector is rather low. There are few success stories of MFIs with good performance. Most have been beset with various operational problems among them high dropout rates. We will return to these problems later.

2.3.2 Regulatory Framework

In Zambia, a specific legal framework for the micro-finance sector has just been passed into law and awaits implementation. The Bank of Zambia and AMIZ have jointly drafted the proposed legal framework. Presently, various statutes are being applied to MFIs operations including the Banking and Financial Services Act of 1994, the Money Lenders Act of 1938 (as amended), the Agricultural Credits Act of 1995 and the Company's Act of 1994. The Bank of Zambia has taken a leading role in ensuring recognition and ad-hoc regulation of this part of the financial market, mainly because of its increasing size and the resulting impact on the economy.

Due to the weakness of the legal framework financial sector authorities often adopt a liberal and flexible policy in order to permit growth in the microfinance credit market. This has been made easier by the fact that donors largely fund MFIs, especially in the initial stages. Therefore, MFIs usually do not take savings from the public at a large scale, thus reducing the risk of fraud and loss of savings. Under the existing legal framework non-bank financial institutions (i.e. financial institutions which are not commercial banks) are not permitted to accept deposits from the general public. However, non-bank financial institutions operating as Savings and Credit Unions registered under the Co-operative Societies Act may accept deposits from members only. The new legal framework has a multi-tiered structure to accommodate different types and sizes of institutions and each tier has specific prudential rules applicable. This Act will enable MFIs to mobilise savings.

The major sources of finance for the MFIs in Zambia include:

- Government loans and grants,
- Donor loans and grants,
- Loans from financial institutions: Banks and Micro-Bankers Trust, and
- Individuals.

2.3.3 Access to Micro-finance Services for the Poor

In Zambia, commercial banks are reluctant to lend to the poor mainly because of the lack of collateral and high transaction costs. The poor would borrow relatively small amounts, and the processing and supervision of lending to them would consume administrative costs that would be disproportionate to the amount of lending. A study by the International Fund for Agricultural Development (UNV, 2000) has confirmed that complicated loan procedures and paperwork, combined with a lack of accounting experience, are other obstacles limiting poor people's access to formal sources of credit. Other reports cite the fact that commercial lenders in rural areas prefer to deal mainly with large-scale farmers. The actual state of the micro-finance sector and its outreach to the poor across the country is rather small (UNV, 2000). The total number of micro-credit borrowers nation-wide is estimated at 20,000 in both rural and urban areas combined (UNV, 2000). This figure clearly demonstrates that the micro-finance sector of Zambia is still in its rudimentary stage.

2.3.4 Important sub sectors financed by the MFIs

In Zambia, the poor are engaged in a variety of economic activities, the most common are discussed below:

Trading: Buying and re-selling of finished goods is the most common micro-enterprise activity funded by MFIs. This sub-sector is growing very fast because of the ongoing retrenchments in the formal sector and relatively easy entry. Vending is relatively well developed in urban areas but is also a major activity in rural areas.

Carpentry: Is rapidly becoming an important activity especially in the urban areas.

Manufacturing: Micro-enterprise manufacturing activities (shoes, clothes etc.) have been funded by some MFIs. This sub-sector remains relatively small mainly because of stiff competition from high quality imports.

Agriculture: Vegetable growing and chicken rearing are the most common agricultural activities financed by MFIs.

Provision of credit for trading activities with quick turnover and high profit margins dominates in micro-lending operations.

2.3.5 Major Constraints for Microfinance Institutions

In their micro-finance operations, MFIs in Zambia face a variety of constraints that fall into three major categories:

Constraints Affecting the Macro-Environment for MFI Operations – Environmental factors

Legal framework constraints: The lack of an appropriate legal framework has proven to be a major obstacle for savings mobilisation and expansion of micro-credit operations.

Poor loan recovery rates are endemic in Zambia. This problem is largely due to poor credit delivery systems. Even in programmes that began with good loan recovery rates, frequently performance deteriorated and ended up with poor loan recovery performance (UNV, 2000).

High Dropout Rates: In excess of 50% (Masumbu, 2000, and Copestake, 1998).

Financial constraints: Shortage of funds for on-lending and capacity building has been cited as a constraint by several studies done in this sector (Mano, 1997).

Transport constraints: The problems range from bad state of roads, non-availability of public transport and high cost of transportation. These problems are retarding progress in the sector.

Constraints Based on Common Institutional Weaknesses among MFIs

Know-how constraints: Shortage of skilled and experienced micro-finance specialists and the high cost of hiring them is a major problem affecting MFIs.

Organisational set-up: Management and administrative structures are commonly either rudimentary or fragile.

Constraints Affecting Performance of Borrowers' Economic Activities

Raw material constraints: Poor access to raw materials has adversely affected performance of the economy especially rural based micro-enterprises in manufacturing.

Information constraints: Lack of information on technologies and markets has adversely affected the economy and in particular the micro-enterprise sector. Limited supply and high cost of communication facilities especially in the rural areas have added this.

High volatility of the agricultural sector due to the variability of climatic conditions

We are specifically focusing on the dropout problem, however many of these problems are inter related and thus we will touch on some during the study.

2.3.6 Past studies on the dropout problem in Zambia

There are very few studies on the dropout problem in Zambia. One of the recent studies is an impact assessment, which included a section on dropouts. An impact assessment of CARE PULSE (Copestake et al., 1998) found a dropout rate of 52%. In the Copperbelt Province a dropout study was done at

CETZAM and found a dropout rate of 32% (Masumbu, 2000). These two studies indicate that dropout rates in Zambia are high.

2.4 The institutions that participated in the study
2.4.1 Peri-Urban Lusaka Small Enterprise (PULSE)
Type of Institution
The Peri-Urban Lusaka Small Enterprise (PULSE) project is a group savings and loan project, which was inaugurated in 1994 by CARE International - Zambia and started operation in 1995. PULSE was launched with funding assistance from CARE Canada's NGO Block Grant, Government of the Republic of Zambia's (GRZ's) Debt for Development and ODA's Joint funding Scheme. In 1996 PULSE secured a five-year commitment of support from the British Department for International Development (DFID) of UK£2,780,000 to expand its operations within Lusaka and evolve into an autonomous financial intermediary. PULSE was registered, as a company limited by guarantee on 24th April 2001 and as from July 1, 2001 will operate as an autonomous microfinance institution.

Maturity of the Institution
PULSE is at intermediate level with a seemingly small outreach of 2,930 active clients. This is however the active clients since the high dropout rate masked the fact that they have reached over 10 000 clients. Its loan product was recently revised following unsatisfactory performance. This did not necessarily improve performance.

Purpose of the Institution
The mission statement of PULSE is to increase household income, economic security and employment opportunities among the families of poor micro- and small-scale entrepreneurs who are constrained by: (a) an unfavourable economic climate, (b) poor business management skills, and (c) lack of collateral due to poor asset base to access capital from conventional banks. PULSE provides credit to micro and small enterprises in accordance with self-sustaining peer based group-lending methodologies, and in so doing foster poverty alleviation through self-employment and job creation.

Availability of Financing
The project provides working capital loans to poor women and men entrepreneurs that would like to expand their businesses. Presently PULSE operates in Mtendere, Mandevu, George, Chawama, Chilenje, Garden and Kanyama townships and recently opened an outlet at Lusaka City Market. Two branch offices supervise the operations.

Loans are advanced to applicants on a graduated basis. Each applicant starts with the lowest level appropriate to the specific business. There are currently four loan levels, after the fourth loan cycle clients may graduate to individual loans. First loans are in the range of K100,000 – K350,000 and all subsequent loans are 1.4 times the previous loan.[5] Presently, the lending rate (interest) is 80 % per annum calculated on a flat rate basis.

Table 1: PULSE Loan Menu

Loan level	Amount (Kwacha)	Repayment Period (months)	Grace Period (weeks)	
			Traders	Manufacturers
1	100,000 – 350,000	3	1	2
2	140,000 – 490,000	4	1	2
3	196,000 – 686,000	6	None	2
4	274,400 – 960,400	9	None	2

Loan repayment intervals and frequency of meetings range from weekly to monthly depending on the loan cycle and type of business as shown below. Repayment is done on specific days for various Sanos (a group of five members). Members are required to make repayment as a group.

[5] Currency exchange rate: ZK3,500 = 1 US$

Table 2: Repayment and Meetings Frequency

Loan cycle	Loan Repayment Intervals		Meeting Frequency	
	Traders	Manufacturers	Traders	Manufacturers
1	Weekly	Bi-weekly	Weekly	Weekly
2	Weekly	Bi-weekly	Bi-weekly	Bi-weekly
3	Bi-weekly	Bi-weekly	Monthly	Monthly
4	Bi-weekly	Bi-weekly	Monthly	Monthly

Since its inception PULSE has given out loans to 10,234 clients but has had serious retention problem such that as at 30th April 2001 only 2,930 clients were active. PULSE has an overall dropout rate of 70 percent as at 30th April 2001, which is extremely high and a significant deterioration from the 1998 figure of 52 percent.[6]

Governance

The governance arrangement is in the process of transition, presently; the senior management at CARE Zambia are responsible for supervising the project and are accountable for grant management. An Advisory Board consisting of 9 individuals of whom two are representatives of CARE Zambia advises the project. This Advisory Board acts as a quasi-governing board, waiting for July 1, 2001 when it transforms into a governing board. Apart from the two CARE Zambia representatives and the Chief Executive, the other members of the board were selected by CARE Zambia from different walks of life and have diverse relevant skills.

Management

PULSE has a management team comprising a Chief Executive Officer, Operations Manager, Finance Officer, Internal Auditor and two Branch Managers. All the management positions are on employment contract of three years renewable. The management is responsible for the day-to-day operations of PULSE and implementation of board policies.

2.4.2 PRIDE Africa - Zambia

Type of Institution

PRIDE Africa - Zambia is a member of the PRIDE AFRICA Group - a network of micro-finance institutions with regional headquarters in Nairobi, Kenya. The mission statement is to create a sustainable financial and information services network for small-scale entrepreneurs to increase income and employment and stimulate business growth across Africa.

Maturity of the Institution

PRIDE Africa – Zambia is a new MFI in Zambia started operations in September 2000. Therefore, in the Zambian context it could be classified as being in start-up stage but is a member of PRIDE AFRICA, which has many years of operations in other African countries. PRIDE Africa – Zambia uses systems and products, which were developed by PRIDE Africa in other parts of Africa.

Purpose of the Institution

The objectives of PRIDE Africa - Zambia are:

- To provide micro and small scale entrepreneurs access to credit services
- To generate business growth and increase employment
- To develop new financial products targeted at the micro-enterprise sector
- To reduce the cost of serving the micro enterprise sector through new technologies.

Availability of Finance

PRIDE Africa - Zambia is currently operational in nine cities and towns, namely Lusaka, Chipata, Choma, Livingstone, Ndola, Chingola and Kitwe. It has a network of ten branches. PRIDE Africa (Zambia) offers the following services:

- Short-term business improvement loans
- Graduation to higher loans over time

[6] This overall dropout rate of 70% was calculated by the authors on the basis of information obtained from PULSE management.

- Access to business information services
- Peer group business development support
- Membership in an established regional micro finance network

Loan Eligibility Criteria:
PRIDE Africa (Zambia) is open to all mature persons who are willing to abide by the company's rules and regulations. Applicants must own a micro or small business located within a five-kilometre radius of the nearest branch. Applicants form their own groups of five people who are not directly related but know, trust and are willing to guarantee one another. All members are required to pay the stipulated registration fee and must attend weekly meetings on time and meet scheduled repayments.

PRIDE Africa (Zambia) advances loans to individual operators through a group-based system of five people called an **Enterprise Group (EG)**. The EG is a group of self-selected persons, who know and trust one another very well and are willing to guarantee each other's loan repayment obligations. Ten EGs are combined to form what is called a **Market Enterprise Committee (MEC).** A MEC is therefore, a group of 50 members or 10 EGs under a democratically elected leadership.

Loans are advanced to applicants on a graduated basis. Each applicant starts with the lowest level. There are currently six loan levels, starting with K280,000 and rising to K3,360,000. The loan repayment is done on weekly basis and specific days for various MEC members. Members are required to observe the discipline of the MEC meetings. Presently, the lending rate (interest) is 25% flat rate for 1st and 2nd loans. For the 3rd and 4th loans the rate is 40% and 50% for 5th and sixth loans.[7]

Table 3: PRIDE Africa-Zambia Loan Menu

Loan level	**Amount (Kwacha)**	**Repayment Period (Weeks)**
1	280,000	25
2	560,000	25
3	1,120,000	40
4	1,680,000	40
5	2,240,000	50
6	3,360,000	50

PRIDE Africa - Zambia has an overall dropout rate of 50 percent, which is very high. Note that at this rate they have to virtually work with a complete set of new clients every two years. Chaisa Branch has recorded the highest dropout rate of 54 percent; this branch is located in Chaisa Township, one of the poorest unplanned settlement areas in Lusaka with high unemployment. This is worrisome as the programme is quite young in Zambia.

Governance
A five-member board of directors governs PRIDE[8]. Board members have tenure of office of three years and this is renewable. The current board was selected by PRIDE Management Services the parent group, from different walks of life and have diverse relevant skills. The board in turn elects a chairperson from among themselves. Future boards might be chosen differently.

[7] This is equivalent to one percent per week for all loans. Note that this does not follow the logic of the group approach where after accumulating more information on clients and building up a track record, clients should surely be regarded as lower credit risks with a commensurate decrease in interest rates (or maybe the entry rates are too low?). Note that the current commercial market rates for similar size loans fluctuate between 50 and 70 percent per annum.
[8] There is a proposal under consideration to increase the number of board members to seven.

Management
PRIDE has a small management team of four persons, the General Manager, Technical Advisor, Administration and Services Coordinator and Management Information Services Coordinator. The management is employed on renewable contract. The management is responsible for day-to-day running of PRIDE and effective implementation of board policies.

2.4.3 Women Finance Co-operative Zambia

Type of Institution
The Women Finance Co-operative Zambia Limited (WFCZ) is a non-governmental organization. The organisation was first registered as a trust in 1987 to support micro and small-scale women entrepreneurs. WFCZ started to provide financial services to its clients (members) after 1994. It later changed its incorporation and was re-registered as a co-operative society on 7th October 1997.

Membership to WFCZ is open to all women who have attained the age of 18 years and are Zambian citizen or a Zambian resident. The organisation has four types of membership namely individual, women's groups, associations and corporate members. The members are required to fill in a membership form, return it with two passport size photos, pay the appropriate membership fee, buy at least one share in the co-operative and pay the annual subscription. The following are the current membership, annual subscription and share fees:

Table 4: WFCZ Membership Fees

Item	Fees in Kwacha
Individual membership (savers inclusive)	10,000
Women's Group (those acquiring loan)	5,000
Associations	20,000
Corporate	20,000
Annual Subscription (for All)	5,000
Share (each)	10,000

Maturity of the Institution
The WFCZ has been in operation for fourteen years (and has provided financial services to clients for the last eight years) and is the oldest MFI in Zambia. However, in terms of maturity, WFCZ could be classified as an intermediate MFI because of limited institutional capacity and outreach.

Purpose of the Institution
The mission of the WFCZ is the economic empowerment of women of Zambia through the provision of financial services (savings and credit) information, training, advocacy and networking so as to enable them to become effective participants in and beneficiaries of all social, economic, political and cultural aspects of the development of Zambia. Therefore, poverty alleviation is the purpose of WFCZ.

Availability of Financing
The WFCZ is currently operational in Lusaka and at Kafue, a small town some 35 kilometres south of Lusaka. The WFCZ has one branch situated at the headquarters in Kabwata Township and also has seven operational offices designated as zones these are at Matero, Bauleni, Kabwata, Chawama, Kaunda Square, Kafue, and Garden townships. One officer services each zone office.

The WFCZ faced many challenges. In addition to a general challenge in the form of the poor macroeconomic situation in Zambia, they also specifically experienced a lack of funds for on lending. The poor economic situation prevailing in Zambia has posed several challenges for women, inter alia, the high unemployment rate, which has forced many women to start micro enterprises, but has also depressed effective demand for the goods and services of micro entrepreneurs. Subsequently this has adversely affected the ability to service loans by micro entrepreneurs and in most cases has led to default and dropout. Consequently WFCZ has faced serious shortage of funds for lending which in turn has limited its outreach. Over the last three years, funding has been erratic and most cases not enough even to meet the existing commitments. The lack of funds to lend has significantly worsened the problem of dropouts

Since its inception WFCZ has given out loans to 2,500 clients but has had serious retention problem such that as at 30th April 2001 only 200 clients were active. WFCZ has an overall dropout rate of 92 percent, which is extremely high. WFCZ ascribes this problem mainly to the mentioned shortage of funds. They have recently acquired adequate funds and improved their disbursement time to within 3 to 5 days from application. They argue that there are already indications that client retention will improve. They also included additional training in their programme.[9]

The WFCZ offers two products a loan and a savings product; the details of the two products are as follows:

The Loan Product

The loan product has three components designated as credit schemes these are Individual, Group and Association schemes and are operated as follows:

Individual Scheme

A member can only qualify for an individual loan after the fourth loan cycle in the group scheme. This graduation is subject to the member having demonstrated good performance under the group scheme.

Group Scheme

The group scheme is the first loan product that is offered to a member. To qualify a member must join a self-selected group of a minimum of five and a maximum of seven members. These group members are required to have already running, profit making, legal businesses which should have been operational for six months or more prior to seeking the loan and should have known each other for that period of time as well. The individual members receive the loan through the group and the group guarantees the loans.

Association Scheme

Under this scheme the Association guarantees the loan and receives the loan on behalf of the Association members. It then disburses and administers this to all its members. WFCZ treats this transaction as having given one loan to the association.

Table 5: WFCZ Loan Menu

Loan Level	Amount (Kwacha)	Repayment Period Months	Repayment Frequency
1	350,000	6	Monthly
2	525,000	6	Monthly
3	787,500	6	Monthly
4	1,181,250	9	Monthly

Individual loan scheme repayment period is one year. However, repayment period is flexible for all loan cycles, clients have an option to repay the loan in less than the stipulated repayment period.

WFCZ offers a grace period of one month or more depending on the nature of the business.

[9] As indicated by their Executive Director, Florence Chibwesha in a letter in reaction to the draft of this report. We would like to acknowledge the prompt response to our request for comments.

Savings Product

The WFCZ savings product operates just like any other savings account in a commercial bank. Members deposit their savings with WFCZ through their savings passbook. WFCZ then deposits such savings with a reputable commercial bank. Interest earned from the savings is calculated on the basis of the rates offered by the commercial bank and is posted in the member's accounts and subsequently in their passbook. Members are allowed to make withdrawals from their savings accounts. The organization also offers services to members who want to open accounts for minors as long as they are female minors. Under the existing banking law WFCZ is not permitted to use member's deposits for on lending.

Governance

The WFCZ is governed by a Board of nine members elected by the Annual General Meeting of the shareholders. The tenure of office of a board member is three years renewable. The Board elects a board chairperson among themselves.

Management

A management team comprising the General Manager, Finance Manager and Program Manager supervise the day-to-day operations of WFCZ and implements board policies. Credit officers assist the management. Credit officers operate from zone offices. Zone offices are all rent-free space donated by various institutions and persons. For example one zone office is a market stand for one of the existing clients and two zone offices are rent-free space donated by local municipal authorities.

3. Methodology and data collection

3.1 Terms of reference

The brief from the client requested that in addition to reviewing (the largely limited) studies already completed on this topic in Zambia, this study would use:

- Qualitative research methods with people who are clients of a variety of MFIs (formal sector banks with deepened outreach and NGO-MFIs – typically 2-3 MFIs in each study country). 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.
- Analysis of selected MFIs' dropouts using data and management information systems from the institutions themselves.

3.2 The Methods Chosen

Although the methods chosen were largely as described in the terms of reference we explain the choice of methods again in this session. A total of 192 persons were met of whom, 125 were women.

Product Attribute Ranking (7 sessions were done):

The application of simple ranking techniques can be used to explore a wide variety of issues when an understanding of the relative importance/desirability etc. is needed (e.g. for understanding the relative importance of different elements of products – interest, rate, opening balance, grace period etc. or the reasons for people leaving an MFI). It therefore assists in understanding what elements of the MFIs' system/product really matter to the client and which do not. The power of this approach is that the client participating identifies attributes, and therefore the results are a pure reflection of client's perceptions and also the order of importance of these perceptions according to the client.

Defining and Ranking the Reasons for Drop-out (16 sessions were done)

This is another application of a simple ranking technique to allow the MFIs to get a clear understanding of the chief reasons underlying the dropouts in their programme. Since this enquiry is about the reasons for exits, we deliberately devoted more sessions to defining and ranking the reasons for dropouts.

Financial sector trend analysis (1 session was done)

Financial sector trend analysis is useful in determining which financial services have been used over time and thus understanding the changes in the use or availability of a variety of financial services over time and why participants used them. This exercise can also be useful in examining the level of competition and popularity among financial institutions both formal and informal.

In Matero there was frequent mention of the existence of other financial service providers and that it was one of the reasons for some exits. Consequently, we decided to do financial sector trend analysis to examine the level of competition and popularity among the various financial services providers. In other locations or branches the circumstances did not justify the use of the method.

Seasonality Analysis (3 sessions were done)
This method is used to obtain information on seasonal flows of income and expenditure, and the demand for credit and savings services. This analysis also provides insights into some of the risks and pressures faced by clients and how they use MFIs' financial services to respond to these. This tool also provides insights into the financial intermediation needs of the community and what products the MFIs can design in response to these. We adjusted this method by adding a category on dropouts. Our question here was aimed at finding out which month's people experience the highest stress and motivations for dropping out and why. This proved to be a successful addition to the list of topics.

Classification of MFIs clients
Since it was not possible to do the wealth ranking we added some questions on client profile and ranking in terms of perceived socio-economic status. Through a participatory process we identified three socio-economic classes namely the relatively better off (the upper class), the managing (the middle class) and the struggling (the lower class). These definitions were used to discuss the characteristics of dropouts.

4. Analysis of results and main findings

4.1 Introduction and approach

Each qualitative session has been meticulously recorded and the results have been summarised according to the techniques used. We present these results clustered per institution. At the end of the section on each institution we present a summary of findings specific to that institution. Thereafter we compare also the findings of different institutions and we come to some overall conclusions where relevant.

4.2 Results of different techniques applied for PULSE

4.2.1 Defining and ranking reasons for drop-out

We started with this method and in the process gained an immediate insight in some of the reasons that may explain dropout of clients. The advantage of this method is that it is entirely client driven in that clients provide the reasons for dropout. We also used this method in interacting with staff members of PULSE and thus can compare the reaction of staff and clients to the same questions.

Annex 1 provides us with the first insight in the reaction of clients of different branches, albeit the same institution. The table presents both the ranking of issues per branch and also overall ranking. We sorted the reaction in terms of overall ranking by clients (referred to as
average ranking in the table). It is clear that the client views pertain to a perceived rigidity of the product of PULSE, and specifically a perception that the product does not accommodate the diversity of their business types and that it also does not fit in with the business patterns. One case in point is that many traders (those in the first and second loan cycles) complained that they do not generate their income on the same milestones as when repayment is required. In the last column we provide staff reaction to facilitate comparison between staff and client reactions[10]. For the discussion we considered reasons that were mentioned more than twice as significant and are discussed below under three groups, loan-related, savings-related and delivery systems-related issues.

Loan-Related Issues
Weekly Repayment
This was the issue most often cited and also ranked as the most significant reason for dropout. Weekly repayment was perceived as too rigid, as it did not adequately take into account the realities of micro businesses, particularly the fact that daily sales volume is usually very small and in some cases over a week these accumulate to a small amount not adequate to cover the weekly instalment. In addition to the heavy burden of this rule, many businesses cannot meet the weekly repayment as the business cycle is longer, or the customers get goods on credit and they pay monthly. Examples were also mentioned of

[10] This is not staff reaction to clients comments but was obtained through running a dropout exercise with staff.

some types of businesses, like cross border traders that leave the country for two to three weeks at a time to buy inventory. At their return they are faced with allegations of default.[11]

- " Because of the short period some members have ended up using the same loan funds to make repayments."
- "Monthly payment is better because people getting goods on credit pay at month-end after receiving their monthly wages."
- "Weekly repayment is a serious commitment it is like marriage"

It is clear that this is a major concern for clients and also a major cause of dropouts. PULSE management last year revised the repayment frequency to that shown in Table 2 (Section 2.4.1). All loans were on weekly repayment prior to that. Most of the dropouts interviewed were not aware of the revised conditions. However, even under the revised product, traders in loan cycle 1 and 2 and recent dropouts complained of the weekly repayment and cited it as a reason for the exit. Our opinion is that there might be good reason to revisit this in view of the unfavourable economic conditions prevailing in Zambia, which has not spared micro businesses.

Loan Disbursement (Turn-around time)

Although under the revised loan product PULSE management thought that they had improved this aspect, many clients including those under or recently exited the revised product felt that the period of waiting for disbursement, especially in-between loans is too long and should be reduced as it adversely affects their businesses. They observed that PULSE advertised to the community that they will help and can solve problems; however when you arrive at the PULSE doorstep, then the waiting starts.

"These delays adversely affect our business plans and are costly as we are forced to keep on coming to check the status"

Most micro businesses have very limited working capital and in addition we learnt that many clients were forced to de-stock their businesses in order to meet loan service obligations. Therefore cannot afford to wait long periods for loan disbursement of subsequent loans. For those waiting for first loans, working capital is usually low and the pre-loan LIF weekly payments worsen the situation.

Loan Use Reallocation

This was cited as a reason for dropout in all the sessions we had using this method. There are a number of reasons why people divert loan funds to uses unrelated to their business, these include paying for school fees, medical fees, funeral expenses etc. We also learnt that there are people who pretend that they have a business when in fact they have none. Such people, we were told do so with full knowledge of some other group members.

"Some people get excited because they have never handled such large amounts before…before the loan, one drinks opaque beer like Chibuku because it is cheap, but after getting the loan one begins to drink expensive beer like Castle Lager because it has now become affordable"

There is a poor debt handling culture in Zambia and this was confirmed in all the sessions we held. Therefore, to solve the problem of loan reallocation will require a concerted effort from all the stakeholders in the microfinance industry in Zambia. It has largely to do with better credit education and countering the negative effects and large defaults of previous government supply-led approaches.

Changing Line of Business

Some clients change their line of business upon receiving a loan. This is usually based on the perception of higher profits in the new business. However, due to inexperience in the new business, such business usually fails and clients consequently default and dropout.

[11] Normally when people make comments about weekly repayment it is related to loan size as it is the larger loans that people find difficult to repay.

PULSE has been emphasising this aspect in the pre-loan training but there are still people who decide to go into new business after loan disbursement. Group members could help to refrain their colleagues from this dangerous practice.

Savings-Related Issues

Loan Insurance Fund (LIF)

The LIF is a source of discontent mainly because of the confusion regarding its operations including interest calculation, the inadequacy of the interest or bonus and the loss of LIF as a result of defaulting colleagues in the group.

- "People lose interest and dropout because of LIF deductions on behalf of defaulters"
- "LIF is supposed to meet our own needs when we encounter problems"
- "LIF is our savings account and should not be used to offset debts of people other than the owner of the account"

It is obvious that the understanding or the expectations of the clients are very different from what PULSE perceives as the function of LIF. Many people cited this as a reason for dropout either because of the loss of LIF or fear that they would lose LIF. The concept of group liability appears to be in question, yet that is the corner stone of group approaches in microfinance. What has gone wrong? We could not find a convincing answer to this question, perhaps that is a subject for further research. We suggest the consideration of distinct differentiation between savings and the LIF, thus still have an LIF but also offer a savings account.[12]

Delivery Systems-Related Issues

Group Size

Prior to last year's product revision PULSE groups were large, clients were grouped into two groups the Gulu (a group of 30 members) and a Sano (a working group of five members). Under the revised product the Gulu has been abolished and the Sano is now a group of 5 to 10 members. The clients cited large group size as a reason for dropout in reference to the period under the old product. It appears this problem has been solved. Clients said that under large group it is difficult to find people whom one can trust but in order to meet the group size requirement clients were being forced to recruit people whom they did not know and consequently wrong people were recruited.[13] Subsequently, these wrong people exited but they also adversely affected good clients through loss of LIF and some good clients dropped out in frustration.

Staff Perception

A comparison of responses shows that of the eight reasons for client dropout identified by PULSE staff only four (Group size, LIF, Loan disbursement delay and Illness and death in the family) were identical to those identified by clients but what is striking is that these reasons were ranked almost the same by the two groups of respondents. Although there is a possibility of staff perception being significantly different it appears that there is some common understanding as to the significance of the reasons.

4.2.2 Product attribute ranking

The clients were asked to mention the attributes of the product PULSE was offering but were also allowed to include attributes that did not exist but were considered important by them and to rank these in order of satisfaction with the attribute most satisfying ranked 1.

Note that Session 2 represents a group of participants who completed their first loan cycle under the revised product, which has longer repayment period and are now engaged with a range of subsequent loans. For these clients the repayment period is seen as positive, while the grace period is regarded as highly acceptable and thus exactly what they wanted

It should be noted that the grace period was introduced with the revised product and has been well received by clients. Prior to the revision the lack of grace period was cited as a reason for dropout. Bi-

[12] Frequently this is a communication problem, especially if this account is confused with a normal savings account.

[13] The whole Gulu was co-responsible for every members' loan.

weekly repayments for manufacturers and traders in loan cycle 3 and above were also introduced with the revision and have been well received.

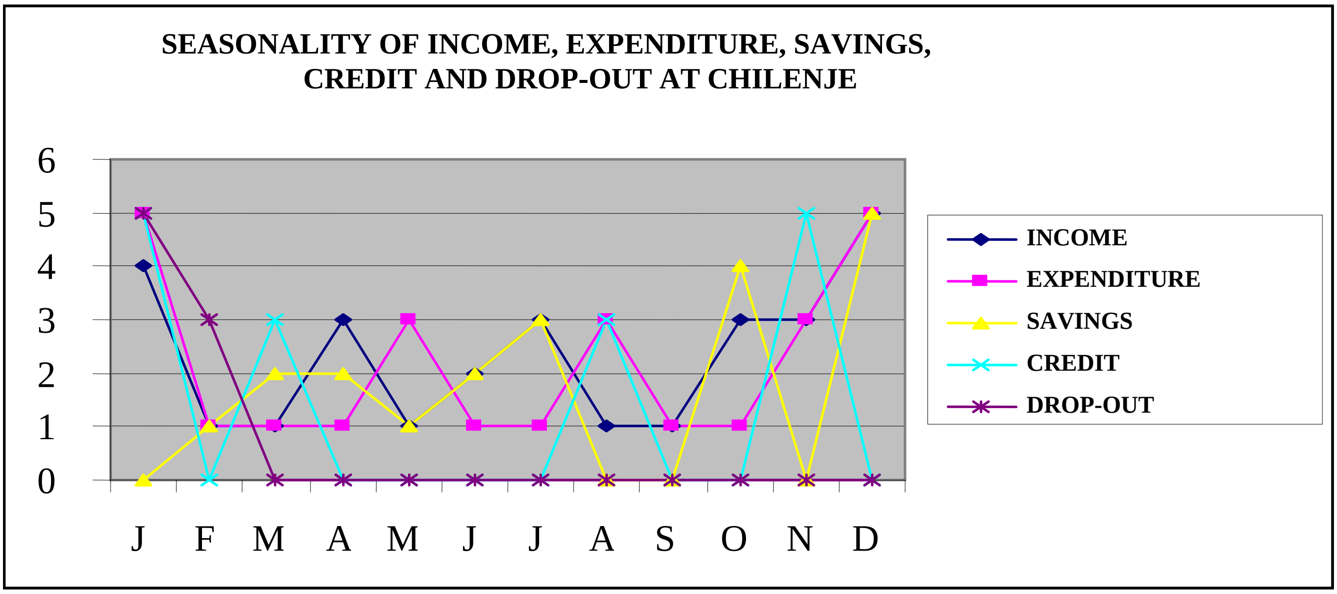
“We are very thankful for introducing the bi-weekly repayments. The spirit should continue.”

Although presently advance payment is not acceptable by PULSE the clients would like PULSE to accept advance payments because they argue that the nature of their businesses is such that during certain periods of the year sales revenue increases and would therefore wish to make advance payment during these good times so that when bad times come they are not over burdened.

The clients are most unhappy with the loan amount; they consider the loan amount too small especially first loan amount. Prior to the revision the minimum first loan amount was K350, 000 it was reduced in the revised product because of poor loan repayment and PULSE thought that clients were being over funded.

Staff Perception
A comparison of responses show that of the eight attributes identified by PULSE staff only two were identical to those identified by clients and the differences in ranking were quite significant. The perception of staff appears to be different from that of clients; the obvious implication of this is that the communication between clients and credit officers is probably not as good as it should be.

4.2.3 Seasonality analysis
Although the clients in the seasonality discussion argued that they have counter cyclical patterns than those of the community (they were mostly traders – and the community will then be buyers of their goods), they succeeded in providing a fair picture for the majority of their immediate community. The concept of immediate community has also to be defined to be quite narrow as they are also peri-urban and urban residents.



Dropout
The innovation here is the addition of the question in which months most people dropout of the system. It is clear that this pressure is the highest in January and February, those months where high claims are made on reserves and income to pay school fees, rent, licences and much more. Also to replenish stock that were sold over the December period, however, another shock is that their clients also suffer from the same high expenditure pattern on school fees and other similar expenses, and thus they decrease their expenditure on the products and services offered by the entrepreneurs and clients of the MFIs. This is therefore a period of high stress on the ability to stay in the system. Among other reasons cited for drop-outs included:

- Different use of loan funds which includes using loan funds on ventures unrelated to the business (consumption) and in some instances borrowing on behalf of other people (who wanted to increase working capital but are unable to borrow directly for various reasons including active clients in lower loan cycle but desire a higher amount. However, many instances occurred where funds were reallocated to consumption rather than production, or even after investment of additional funds in the business profit did not increase and it was difficult to service the higher loans.

- Inadequate loan amount refers to loan amounts that fail to take into account the reality of business for example minimum order for a bale of second hand clothes is K350,000. Therefore a loan of lesser amount would be inadequate.

- Poor selection of group members (some people are co-opted into the group without sufficient background information as result untrustworthy characters are chosen)

Income
December is the peak month of high income propelled by Christmas bonuses and Christmas shopping while January is also relatively high-income month for those in the clothing industry because of school uniforms demand. For those selling soft drinks, October and November are high-income months. April and July are also high-income months due to the Easter and July holidays.

Expenditure
December and January are peak months of high expenditure fuelled by Christmas celebrations and school requisite and fees respectively. May is also a relatively high expenditure month due to 2nd term school fees.

Savings (Bank, LIF, Cash at home, Inventory, Assets - fixed, knowledge, livestock)
July, October and December are high savings months because of higher incomes associated with July holidays and warm clothing purchases and in October associated high sales of soft drinks during the hot season. In December surplus income is due Christmas shopping.

Credit
January there is a great need for credit for school uniforms and school fees. In March credit is for stocking in preparation for Easter holidays and August November and stocking for Christmas shopping. Usual sources of credit are PULSE, Kaloba (moneylenders), Chilimba (ROSCA) and friends/and relatives.

The relevance of this method is that it attempts to explain the seasonality aspect of the dropout problem and how it relates to factors such as income, expenditure, savings, and credit. This information is useful in product design, for example an MFI could design a product, which offers a rest during the first quarter of the year. This might improve the client retention rate.

4.2.4 Focus group discussions

The study used a variety of participatory group discussions (as discussed in the previous section) to obtain information and combined this with information obtained during focus group discussions. These discussions were focused on specific questions related to reasons for dropout and specific areas of interest arising from the initial group discussions were probed. Annex 3 provide a summary of the questions covered in the focus group discussions and also gives an indication of the reaction of the participants.

The discussion identified nine major reasons for dropping out, these are:
- Weekly repayment
- Loan use reallocation
- Loan promises by PULSE not honoured
- Theft of business assets
- Grace period inadequate
- Loan Amount inadequate
- Poor business due to competition from big shops like Shoprite
- When financial needs are met
- Paying for defaulters (depletes ones capital)

The discussion also identified the following issues:

- That more people were still dropping out notwithstanding the recent revisions to the loan product
- That some clients are expelled by the group, while others dropout voluntarily
- That PULSE should offer individual loan product
- That clients desired to see the loan repayment extended and also that PULSE should accept individual payments and not insist on the whole group paying at the same time
- That some clients have moved to other MFIs, probably in search of better conditions
- That there are people eligible to join PULSE but choose not to because of alleged fear of property seizures
- There are people who join two or more MFIs in order to increase capital, because MFIs offer small loan amounts for first and second loans and others do so because of dishonesty

A comparison of Annex 3 responses with the issues discussed under different methods above shows that a number of issues are similar notwithstanding the different techniques used. We will return to this triangulation in the summary section.

Interviews with those not joining
We also interviewed two micro entrepreneurs at George Market who have never joined any of the MFIs operating in the area. When asked why they never joined replied that:

- MFIs money is magical it makes you poorer, we have seen people who rushed into loans from MFIs who have ended up poorer than before, they even lost household furniture
- I understand that when you get a loan you are required to service the loan on weekly basis without fail, but my business of selling hardware materials for home maintenance cannot raise enough money to meet weekly repayments. A colleague in the same business who tried failed to service her loan

4.2.5 PULSE summary of findings
The previous section highlighted the results obtained with different techniques and at different branches. In this section we combined the reactions of the different clients to try and obtain a consistent message or pattern. We do this analysis based on three tables presented. The PULSE tally table in Annex 4 shows that the five major causes of dropout are:

Loan Insurance Fund (LIF)
The LIF is the major cause of dropout mainly because of the confusion regarding its operations including interest calculation and the loss of LIF as a result of defaulting colleagues in the group. Before the revision, the inadequacy of the interest or bonus was a significant issue but this has now changed because interest on LIF was increased to 20% per annum. But clients appear not to be aware of the new conditions.

Loan Disbursement (Turn-around time)
The revised loan product appears not to have adequately responded to the problem of loan disbursement delays. Many clients including those under the revised product felt that the period of waiting for disbursement, especially in-between loans is too long and should be reduced as it adversely affects their businesses.

Weekly Repayment
Although under the revised product many of the concerns were addressed, weekly repayments is still perceived as too rigid and still a cause of exit among traders in loan cycle 1 and 2.

Group Size
Prior to last year’s product revision PULSE groups were large, and clients hardly new each other. The clients cited large group size as a reason for dropout in reference to the period under the old product.

Loan Use Reallocation
There are a number reasons why people divert loan funds to uses unrelated to their business, these have been discussed above.

Table 6: Characteristics of Dropouts - PULSE

AGE	GENDER	MARITAL STATUS	SOCIO-ECONOMIC STATUS
The majority of dropouts are young people both male and females.	Men are prone to dropout because they do not like to work in groups, while women feel more secure working in groups.	Most dropouts are single because single people are more mobile and have no spouse to assist to service the loan.	Most dropouts come from the relatively better-off and struggling classes.

4.3 Results of different techniques applied for PRIDE
4.3.1 Defining and ranking reasons for dropout
Annex 5 is a summary of the reasons for dropouts that were identified by this method; for the purpose of our discussion we have selected a few on the basis of frequency of mentions.

Loan-Related Issues
Weekly Repayment
Weekly repayment was identified as one the main reasons for dropout. Clients argued that the system was unrealistic because it over states the ability of most business to generate revenue to service the loan within such a short period of time. For example it is unrealistic to expect a carpenter to service a loan on a weekly basis because carpenters rarely sell on cash basis most of the sales are on 30 or more days credit[14]. The system puts clients under pressure which forces even good clients to dropout due to fatigue.

From PRIDE's point of view weekly repayment is seen as necessary to enforce discipline. But the reality seems to be suggesting a revision of this policy, as it is presently counter productive.

Loan Disbursement
Turn-around time between loans is reported to be very long (as long as two weeks) this frustrates clients mainly because of the adverse impact the delay has on business liquidity. This delay in loan disbursement was also reported to have caused business failures. It is certainly a major cause of dropouts both voluntary and involuntary.

"Now I'm stuck, six weeks I cannot get a new loan."

PRIDE management explained that the delays are mainly due to the inability of the clients to secure the number of people to constitute an EG after the departure of their colleagues. Since the current delivery system requires that an EG must have five members, it is up to the client to recruit the required number.

Loan Use Reallocation
Loan use for applications other than mooted when the loan was given was mentioned very often in the discussions, when probed clients said that there are two types of loan misuse, the most common is due to pressure from other pressing and urgent needs such as school feels, illness and death of family members. They also said that there are few people who intentionally borrow with a view to diverting the funds to personal use or are too excited to handle a large sum of money for the first time in their lives.

PRIDE could minimize loan use reallocation in many ways, for example by introducing products that would be available to meet these other needs. A school fees loan product would be an example in this regard.

Loan Amount

[14] At the time of the study there were 16 Carpenters in the loan portfolio of Chaisa branch.

Most clients considered first and second loan amounts as inadequate, they argued that the amounts are too small for their businesses to reach a critical mass for expansion and in some cases not adequate to purchase the required stocks, for example good second hand clothes.

> "I deal in salaula (second hand clothes) for my business to make money I have to purchase very good quality salaula but that costs K380,000 per bale. While here at PRIDE they are offering a loan of K280,000, not enough to buy a bale"

Clients disclosed that because of the inadequacy of the loan amount they are forced to engage in multiple borrowing either from other MFIs in the area or from informal market sources such as Kaloba (moneylender) and Chilimba (ROSCA). The consequence of this is that loan servicing becomes cumbersome and subsequently leads to default which results into voluntary or involuntary dropout.

One possible way to address this problem is to design a loan menu that takes into account the minimum needs of a particular line of business.

Savings-Related Issues

Loan Insurance Fund (LIF)

The LIF appears to be grossly misunderstood by the clients, the general view of clients is that LIF is a personal savings account, which could only be forfeited if the owner of the account defaulted on her or his loan servicing obligations. They do not understand why they should lose LIF on account of default by MEC members whom they do not even know. They argued that if the liability were limited to EG members one would understand because they recruited each other.

The loss of LIF was identified as one of main reasons for the high dropout rate. Clients said that even good clients were leaving because of the loss of their "savings". It would appear the concept of group liability is not fully understood or accepted. The efficacy of group liability in microfinance requires further research.

In addition clients complained of interest on LIF not being credited to their accounts despite the assurances from PRIDE. This is partly due to the lack of information that clients have on their loan balances. In our discussions with staff they argued that it is a function of inadequate information, yes, but also a lack of understanding of their passbook contents. This implies better client training is needed.

Delivery System-Related Issues

Lock-in System

PRIDE has a system of putting pressure on the whole MEC until money is raised to meet the short fall. This system is strongly resented by clients and has caused some clients to dropout. Clients felt that the lock-in system was disrespectful to clients and also tarnishes the image of PRIDE. They argued that PRIDE should treat its customers with the respect they deserve as adults. Clients felt they were being over burdened by having to pay on behalf of their colleagues and at the same time threatened with the loss of LIF.

Group Liability

Group liability is an essential aspect of the group lending methodology, but clients at PRIDE felt the liability should be limited to EG members and not extended to include MEC members. They argued that EG members self select each other but do not do so for the MEC members and very often they do not know the backgrounds of each MEC member.

Other Issues

Business Failure

Clients mentioned business failure as a significant cause of dropouts. They said that many micro trading businesses are failing because of competition from big shops such as Shoprite Checkers.

Unfavourable Economic Conditions
Zambia is presently experiencing unfavourable macroeconomic environment of high inflation, unstable currency exchange rate and high unemployment all these factors have had a negative impact on the performance of micro businesses. The consequence of this has been very high business failure rate and many micro businesses have problems servicing loans.

4.3.2 Product attribute ranking

The clients were asked to mention the attributes of the product PRIDE was offering but were also allowed to include attributes that did not exist but were considered important by them and to rank these in order of satisfaction with the attribute most satisfying ranked 1. Note this session represents a group of eight participants of who five were in first loan cycle and three in second loan cycle (Annex 6). For these clients the policy to write-off the loan balance of deceased clients is seen as positive, while the pre-loan training is regarded as highly desirable. They also appreciate the opportunity to learn from each other, which the weekly meetings facilitate.

Although loan amounts in the higher loan cycles were considered reasonable, clients felt that loan amounts for first and second loan cycles were inadequate for most businesses. On the appraisal system they felt that the system was good because it was simple but were unhappy that they are required to approve by acclamation the suitability of applicants from other EGs whom very often do not have sufficient background information. They felt they were being forced to make false declarations.

Clients were unhappy that PRIDE does not offer grace period on loans, they argued that a grace period was necessary to enable them procure the stocks.

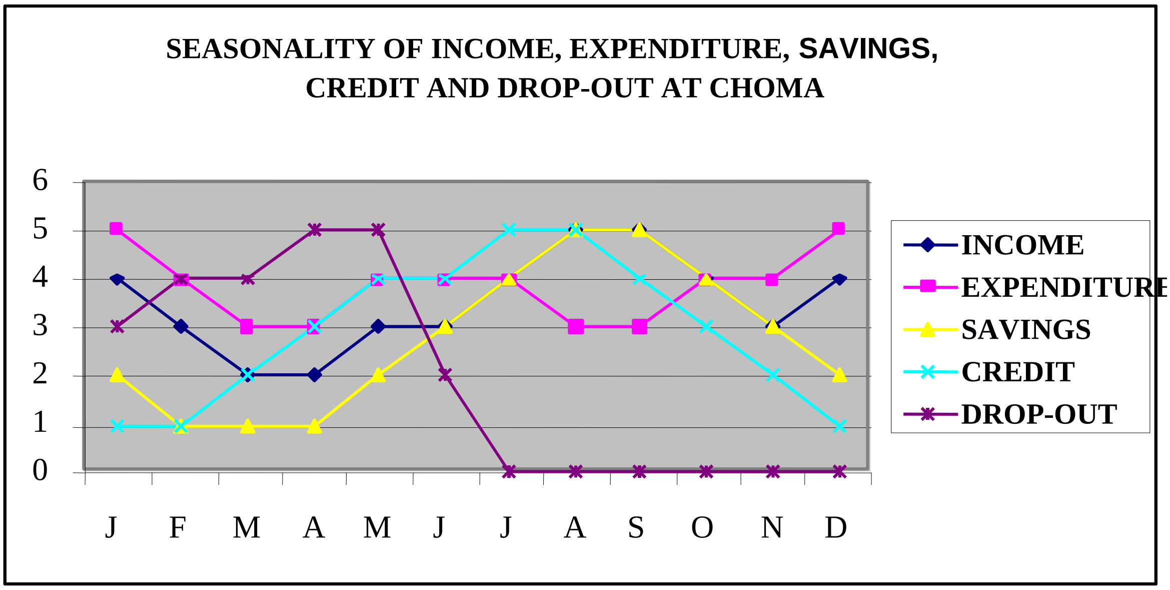
> " I sell chickens at the market here in Choma. I buy these chickens from the villages in Sianazongwe, there is no reliable public transport, and the only transport is on weekly basis when the local parish priest comes to Choma on Saturdays. Whenever I go for orders I miss my Tuesday repayment day. How long can my colleagues keep paying for me?"

Weekly repayment was ranked, as the least satisfying attribute because they felt it did not take into account the realities of most micro businesses.

> "I'm a fine Artist and my revenue comes at month-ends, yet here at PRIDE they expect me to service my loan on weekly basis. How? It is very difficult, if not impossible. I have to borrow from friends in order to service my loan."

4.3.3 Seasonality analysis

We conducted two sessions of seasonality of income, expenditure, savings, credit and dropout at Choma and Chachacha branches. The two branches were purposefully chosen because Choma is a rural branch while Chachacha is an urban branch and we wanted to capture the differences if any. Choma is a small farming town in the Southern Province of Zambia, some 350kms from Lusaka.



Income
While the town has some income throughout the year, however income is highest in the months of June, July, August and September as farmers harvest and sell crops, mainly maize. In October there is income from selling of soft drinks because of the hot weather while in December more sales are due to Christmas festival. In January again more sales especially to those dealing in school requirements. February to April the income drops because of the rainy season and the farmers have run out of money to spend.

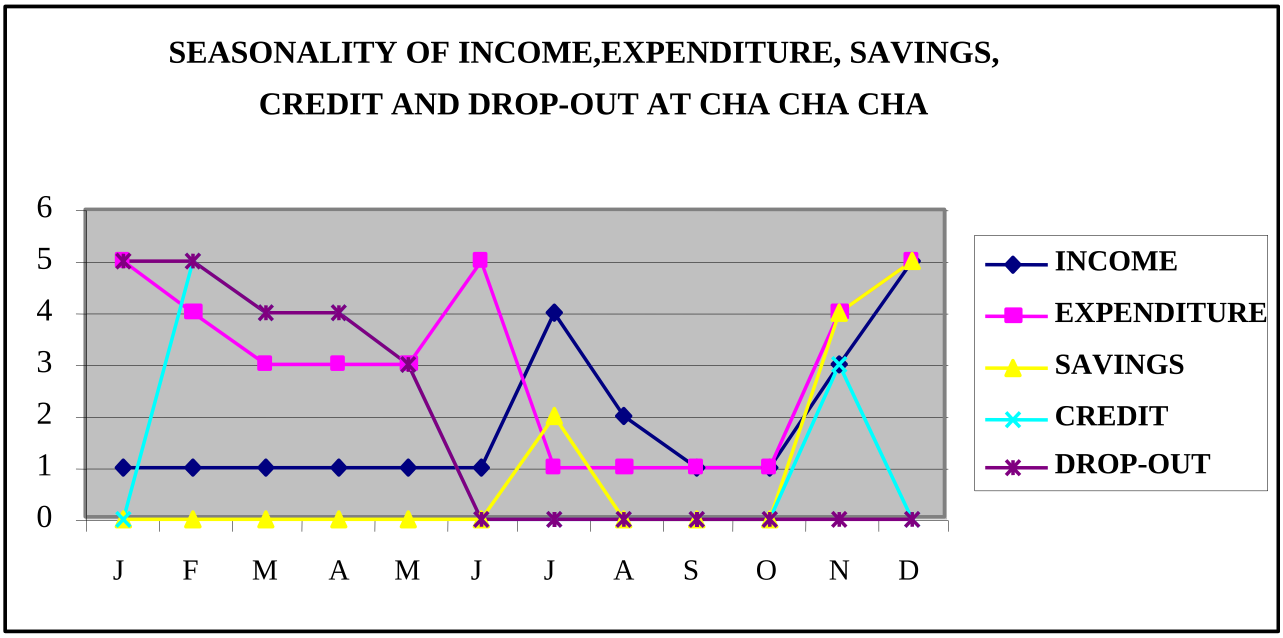
Expenditure
They said that in January and February there are more expenses because this is the time they buy school requirements. As most members do farming as well, there is more spending in October and November because they are buying inputs in preparations for the planting season and Christmas festival.

Savings
Between June and September members do save mainly because farmers who are the main buyers have more money to spend because they are selling their crops. October and November they have more income this time because farmers are again buying inputs in readiness for the planting season. In the months of December and January there are little savings if any as they are spending the money on Christmas festival season and are buying school requirements. February to April they have the lowest savings. A variety of savings services are used ranging from savings accounts at commercial banks, forced savings at PRIDE, Livestock to ROSCAs

Credit
The members accrue more debts between the months of April and September because the rainy season has ended and are now borrowing to re-stock in readiness for high demands in the months of October through to January. The major sources include PRIDE, Kaloba (moneylender) and Chilimba (ROSCA.)

Dropout
The highest dropouts were observed during the period January to May this is the period when sales are low and consequently clients have difficulties to service loans. It was reported that at this time of the year clients borrow from the informal financial market to service loans and buy school requirements and re-stocking businesses. Dropouts are lowest between June and December because there is more business during this period.

Chachacha Branch
Chachacha Branch is located in the city centre of Lusaka, the clients of the branch come from the nearby City and Soweto markets.



Income
The highest income is recorded in June, October and December. In June increased income is due to the shopping by farmers after crop sales and also sales associated with the cold weather such tea, sugar and warm clothing. In October sales are boosted by the high demand for soft drinks associated with hot weather. While in December increased sales are due to Christmas festival and the annual bonuses awarded to employees.

Expenditure
High expenditure is recorded in the months of January, February, March, May, October and December. Expenditure is high in January and February because of school requirements. While in March and May its mainly payments of arrears on rent and electricity and to a small extent restocking business. In October and December the increase is due to restocking of business and the Christmas festival respectively.

Savings
Savings are highest in the months of June, October, and December. The savings pattern follows the months of high sales. The main savings services used are ROSCA, LIF at PRIDE, Livestock and cash hidden in the house.

Credit
The highest demand for credit is recorded in the months of February, March, April and October. The demand in February is mainly for school fees and in March, April and October the demand is mainly arising from the need to restock businesses. Main sources of credit include PRIDE, Kaloba, friends and relatives.

Dropout
The highest dropouts are recorded in January, February, March and April. These are the months of poor business arising from the bad weather and low liquidity in the market.

Comparison
A comparison of the two branches shows that the income pattern is different as would be expected. The expenditure pattern is also largely similar with small differences. The savings pattern is very different as would be expected. The demand for credit pattern is equally different. The pattern for dropouts is almost the same. Both experience massive dropouts during the first quarter of the year. Another aspect that was raised with respect to dropouts by both urban and rural clients was that it was clear that the first quarter of the year is particularly bad for micro businesses because most of them are conducted in the open and therefore are adversely affected by the rainy season during this part of the year.

4.3.4 Focus group discussions

Annex 7 provides a summary of the questions covered in the focus group discussions and also gives an indication of the reaction of the participants.

The discussions identified the following main reasons for dropping out:

- Burdensome weekly repayment
- Loan use reallocation
- Starting business with loan funds
- Theft of loan funds/business assets
- Poor business due to competition from big shops like Shoprite
- Thought the money was a grant

Other issues identified are that:

- More people are leaving because of weekly repayment and loss of LIF due to default of colleagues in the group
- Some members are expelled while others dropout voluntarily
- PRIDE should introduce bi-weekly repayment
- PRIDE should accept repayment from individuals and not insist on group payment
- LIF deductions should be confined to EG members in the EG of the defaulter and not extended to MEC members
- The system of detaining the whole MEC when some people fail to fully pay the weekly loan service should be discontinued
- Some people moved to other MFIs because loan conditions were assumed to be better, i.e. have grace period and biweekly repayment
- There are people who are eligible to join PRIDE but choose not to because of alleged fear of property seizures, detentions at MEC meetings and weekly repayment. They learn this from present and former clients of PRIDE
- Some people join more than one MFI at a time because they want to increase capital base

A comparison of Annex 7 responses with the issues discussed under different methods above shows that a number of issues are similar notwithstanding the different techniques used. We will return to this triangulation in the summary section below.

4.3.5 PRIDE summary of findings

The previous section highlighted the results obtained with different techniques and at different branches. In this section we combined the reactions of the different clients to try and obtain a consistent message or pattern. We do this analysis based on Annex 5, 6, and 7 presented above. The PRIDE tally in Annex 8 shows that the five major causes of dropout are:

Weekly Repayment

Weekly repayment was the most often cited cause for drop out among PRIDE customers. Weekly repayment was mentioned in all except one session.

Loan Insurance Fund (LIF)

The LIF was also mentioned in all except one session, it is equally a major cause of dropout at PRIDE.

Loan Amount

The inadequate first and second loan amounts were mentioned as a cause of dropout in six out of nine sessions, clearly this is a significant cause.

Lock-in System

The lock-in system was mentioned as a cause of dropout in five out of nine sessions, it is obviously a significant cause of dropout.

Loan Use Reallocation
Loan use reallocation scored the same as lock-in system it is a serious problem and a significant cause of dropout.

Group Liability
Group liability frustrates good clients and many are forced to exit. This attribute scored the same as lock-in system and is a significant cause of dropout.

Table 7: Characteristics of Dropouts - PRIDE

AGE	GENDER	MARITAL STATUS	SOCIO-ECONOMIC STATUS
Dropout rate is higher amongst youngsters. They appear less serious with their businesses. Youngsters are doing business as an interim occupation while waiting for formal employment.	Dropout is usually lowest among elderly women and highest among men especially young men.	Married women and men are stable and less likely to dropout. They usually take their obligations more seriously and in times of hardship with loan servicing they usually receive help from spouse. Single men and women are more likely to dropout as they are more mobile and also prone to illness and death (HIV/AIDS related).	Most dropouts come from the struggling class because this is a class more inclined to misuse the loan funds. Probably, as a result of limited resource base. The relatively better off are also prone to dropout because they do not like working in groups especially with people whom they consider low in social status.

4.4 Results of different techniques applied for WFCZ
4.4.1 Defining and ranking reasons for dropout
Annex 9 is a summary of the reasons for dropouts that were identified by this method; for the purpose of our discussion we have selected a few on the basis of frequency of mentions.

Loan-Related Issues
High Interest
In 1998 WFCZ obtained a loan from MBT, because of the high cost of these funds the on-lending rate was fixed at 80% per year. Presently the rate is 72% per year, still higher than the industrial average rate of 50% per year. Most of the participants were referring to the 1998 interest rate. This high cost of borrowing was identified as a major cause of dropout.

> “At the end you find that you have no money so you ask yourself does it mean I was only working for WFCZ?”
>
> “ You find that at the time you finish your loan (repayment) even your money is finished”

Loan Disbursement
The WFCZ has a serious problem of delays in loan disbursement mainly because of a liquidity problem the institution has faced in the recent years. WFCZ estimates that 68% of dropouts were forced to do so because the institution had no funds to meet their requirements.

In the course of this research the consultants spoke with two clients who have been waiting for their first loans, six months after training. These clients were very frustrated and indicated that they were dropping out.

Loan Amount
The loan amounts range form K350,000 for the first loan to K1,181,250 for the fourth loan, depending on the nature of the business. Clients felt that these amounts are small. These small loan amounts have encouraged multiple borrowing.

Other Issues
Business failure was cited as a major cause of dropout. The high number of business failures is mainly a consequence of delays in loan disbursement, high interest and inadequate loan amounts and unfavourable macroeconomic environment.

4.4.2 Product attribute ranking
The clients were asked to mention the attributes of the products WFCZ was offering but were also allowed to include attributes that did not exist but were considered important by them and to rank these in order of satisfaction with the most satisfying ranked 1. For these clients the grace period is regarded highly acceptable, while the repayment period is seen as positive. Business training and savings facility are highly appreciated by the clients.

Clients felt that interest on loans was very high and is a major source of discontent and dropouts at WFCZ, the management is aware of this problem and have made some effort to resolve this problem. It was also a general feeling by the Clients that loan amounts were small in view of the high inflation in Zambia.

Clients are not very happy with the interest earned on their savings; they felt the interest was inadequate compared to the market rate in the commercial banking sector.

Loan disbursement was ranked as the most unsatisfying attribute of the loan product because of the delays experienced too often.

These findings are consistent with what we found using other methods above.

4.4.3 Financial Sector Trend analysis
We carried out financial sector trend analysis at Matero because clients mentioned in other sessions that there was high competition among financial services providers in Matero. We therefore decided to identify the trends to facilitate our understanding of the impact of this competition on dropout rates. Below is a summary of our findings.

WFCZ
Five years ago many people were attracted by good conditions such as small loan amounts of K100,000 and did not demand collateral for the loans. However, two years ago WFCZ stopped giving loans because there were too many defaulters. Recently there has been an upturn in the number of people obtaining loan and banking services from WFCZ. But the number would have been higher had it not been for high interest rate on loans, joint liability which tends to penalize good clients and low interest rate on savings which discourages many people wishing to save. In reaction to this study WFCZ mentioned that they indeed have the highest number of defaulters in their Matero branch. They also sent around a list of defaulters to other institutions in the area, thus starting an informal credit bureau.

Ecumenical Church Loan Fund
Five years ago a little more people had business dealings with this institution but in the recent years only few people have business dealing with this institution. Very few people in Matero community know the existence of this institution.

PULSE
PULSE was very popular five years ago because of an effective publicity campaign and fast loan disbursement. Two years ago suffered a major setback as result of some dishonest staff and failure to honour the promises in respect of the Loan Insurance Fund (LIF). Recently there has been an upturn in the number of clients joining this institution as result of some improvements in the loan conditions but LIF is still a problem.

PRIDE
This institution came to Matero in the last two years. Was very popular at inception because it promised good conditions but in recent years popularity has declined because of weekly repayment system.

CHILIMBA
Chilimba (a rotating savings and credit fund) is a very popular source of funds for women micro entrepreneurs in Matero. Among the reasons for popularity is proximity; no interest charged on loan and the only condition is that one must be a contributing member of a group.

KALOBA
Kaloba (Moneylenders) is usually a source of funds for men. Was relatively more popular five years ago, its popularity has declined over the years mainly because competition from MFIs and high interest rate of 100% that could be doubled if one fails to repay on time.

National Savings and Credit Bank
Five years ago was very popular because minimum balance requirement was small and appropriate to the requirements of the micro entrepreneurs and also offered loans. Has a wide branch network including one at Matero and clients can transact from any branch. In recent years popularity has declined because of limitations on amount a client can withdraw in a single transaction as a result of a liquidity problem the bank has been experiencing.

Barclays Bank Zambia
Five years ago there were many people from the Matero community who had accounts with this bank because they anticipated loans but when this was not forthcoming popularity begun to decline.

Zambia National Commercial Bank
This bank has been popular over the last five years because of the belief that it is a big and strong bank and therefore unlikely to collapse. It also offers attractive interest on savings; most retirees particularly from the public sector have opened accounts at ZANACO. It is believed to provide bigger loans but access is limited to customers able to offer collateral.

Standard Chartered Bank
Five years ago many people were going to the bank with the hope of obtaining a loan. Usage/Popularity has declined over the years due to the inability of the bank to meet clients' needs.

4.4.4Focus group discussions based on discussion guides
Annex 11 provides a summary of the questions covered in the focus group discussions and also gives an indication of the reaction of the participants.

The discussions identified the following main reasons for dropping out:
- Loan disbursement delays
- Loan use reallocation
- Share contribution
- Loan Amount inadequate
- Group liability (depletes ones capital)

Other issues identified are that:
- More people are leaving because of delays in loan processing and disbursement
- Some people are expelled while others dropout voluntarily
- Fees are too many, WFCZ should reduce the number fees and also amount charged
- WFCZ should offer individual loans
- WFCZ should follow-up defaulters not group members
- WFCZ should consider increasing repayment period
- Some women have moved to other MFIs because of delays in loan processing and disbursement
- There are people eligible to join WFCZ but choose not to because of negative publicity being promoted by dropouts and some are afraid of loan conditions
- Some people join more than one MFI in order to increase capital and some do so because they are dishonesty.

A comparison of Annex 11 responses with the issues discussed under different methods above shows that a number of issues are similar notwithstanding the different techniques used. We will return to this triangulation in the summary section below.

4.4.5 WFCZ summary of findings

The previous section highlighted the results obtained with different techniques and at different branches. In this section we combined the reactions of the different clients to try and obtain a consistent message or pattern. We do this analysis based on Annex 9, 10 and 11 presented above. The WFCZ overall tally in Annex 12 shows that there are four major causes of dropout:

Interest on Loans

As discussed earlier WFCZ interest on loans is slightly higher than the industrial average and consequently it is a major source of discontent and affects client retention negatively. This problem is a result of a commercial loan WFCZ obtained from MBT.

Loan Disbursement (Turn-around time)

Loan disbursement problems affect the clients at two stages, delays in disbursement of first loan and delays in disbursement of subsequent loans (usually referred to as lengthy turn-around time). In terms of impact on client retention this probably has the highest negative impact. As stated earlier WFCZ estimates that 68% of dropouts were forced to do so by these delays. These delays are not intentional or administrative inefficiency, but are due to lack of liquidity that has beset WFCZ for some time.

Loan Amount

The clients consider loan amounts, particularly for first and second loans inadequate. This problem is mainly a result of the rapid depreciation of the Kwacha and generally a reflection of unstable macroeconomic environment.

Fees

The fees structure of WFCZ has been identified as a significant cause of dropouts; in particular disbursement fees and the 10% share contribution are the most unpopular.

Table 8: Characteristics of Dropouts - WFCZ

AGE	GENDER	MARITAL STATUS	SOCIO-ECONOMIC STATUS
About 70% of dropouts are youth aged 30 years and below. These young people are unstable, speculative and believed to be more prone to wilful default.	Not relevant because WFCZ is exclusively for women.	Relatively more dropout among single women because they are usually young and mobile.	Most dropouts are from the “Managing class” because this is a class of people who are mostly young.

4.5 Main findings for all institutions

4.5.1 Introduction

Although institutional context differ on the basis of many variables we would like to make a few general observations on the findings that are very similar for the different institutions. We do this on the basis of two common denominators, first, the institutions operate in the same country and they have remarkably similar products and delivery systems. It is as if somebody studied Zambia carefully and decided that this will be the best way to offer micro finance services in the country, or somebody decided without any thorough preliminary studies that this is the best for the Zambian situation. The latter approach normally has dire consequences. One cannot help but to notice that this is not a Zambian specific problem and that research in many other African countries have similar findings.

4.5.2 Main findings on the basis of specific techniques for all institutions

The main findings for all institutions per technique are discussed below:

Ranking of Reasons for Dropout Sessions
These PRA sessions identified nine major reasons for exit of these the most often mentioned was LIF closely followed by Weekly repayment, delays in loan disbursement and loan misuse. High interest rate although more prominent in one institution was also quite significant on overall rating. Detailed analysis is in Annex 13.

Table 9: Major Reasons for Dropout

REASON	MENTION SCORE
Loan Insurance Fund (LIF)	11
Weekly Repayment	9
Loan Disbursement	9
Loan Use Reallocation	9
Group Liability	8
Loan Amount	7
Poor Business	7
Group Size	6
High Interest	5

Focus Group Discussions
The focus group discussions identified nine major reasons for dropout of these the most often mentioned was Loan use reallocation and Group Liability. Detailed analysis is in Annex 14.

Table 10: Major Reasons

REASON	MENTION SCORE
Loan Use Reallocation	4
Group Liability	3
Weekly Repayment	2
Repayment Period	2
Loan Disbursement	2
Loan Amount	2
Group Repayment	2
Lack of Credit Officer supervision	2
Theft of Business Assets	2

The combined techniques identified nine major reasons for dropouts of these most often mentioned was Loan Disbursement delays, Loan use reallocation and Group Liability. Detailed analysis is presented in Annex 15.

Table 11: Major Reasons for Dropout (Overall Tally)

REASON	MENTION SCORE
Loan Disbursement	15
Loan Use Reallocation	13
Group Liability	13
LIF	12
Weekly Repayment	11
Loan Amount	10
High Interest	7
Poor Business	7
Group Size	6

4.5.3 Main findings of the study
We highlight the six main findings of the study and discuss each in one paragraph, then we conclude with a few general observations, also on the methodology used, including shortcomings of the study.

The Main Findings

Loan Disbursement

Delays in loan disbursement were identified as the major reason for dropouts among the three institutions in this study. The reasons for the delay include lack of funds to disburse, clients failing to form groups and administrative lapses.

Unilateral reallocation of loan use by client

This phenomenon was quite common amongst many clients. Our assessment is that it presents a clear indication of a demand for loan products in addition to the demand for loans for investment in entrepreneurial activity. This should not really be a problem if clients still repay the loans, however, some clients divert to another business plan and cannot meet the repayment requirements. In this case the loan reallocation leads to default. Zambia also has another problem due to its past of government financed supply led programmes. The market has been polluted by previous loan schemes promoted by the Government, which did not punish wilful loan defaulters. This problem will remain for a long time until contract enforcement becomes a norm and effective. MFIs should lobby for appropriate legislation to facilitate speedy prosecution of wilful defaulters.

Group Liability

Group liability has become a major source of discontent and subsequently dropouts. Since group members are collectively liable for each other debts, wilful defaulters overburden good clients who have to service not only their loans but also those of their defaulting colleagues. This indicates more emphasis needed with the training of groups in the selection of group members. In addition one has to note the inherent difficulties in applying the self-formation of groups in the urban market context. An example is an MFI office in Chachacha (Lusaka) serving three different market areas in the surrounds. It is virtually impossible to ensure group formation of groups who know each other intimately.

Loan Insurance Fund

The LIF appears to be misunderstood by most clients who consider the LIF as a savings account and not as a group insurance fund. Consequently, any attachment draws negative reaction from clients.

Weekly Repayment

Weekly repayment has been described as stressful by clients even those with businesses that can raise enough money in a week to service a loan. For some businesses it is impossible to raise enough money in a week to service a loan. Consequently, many clients are forced to seek a rest after a loan cycle, while others dropout because their businesses cannot service a loan on a weekly basis.

Loan Amount

Loan amounts, particularly first and second loans are considered inadequate for most businesses. Consequently, some clients have been forced into multiple borrowing from the informal market or other MFIs, which usually results into failure to service the loans.

General Observations

The microfinance industry in Zambia to grow and attain sustainability must tackle the problem of low client retention vigorously and urgently. The problem is real and serious. However, we are confident that there is enough desire and commitment among Zambian MFIs to overcome this constraint.

The participatory research methods used in this study have a built-in mechanism for moderating responses and therefore, we are confident that these results reflect a true picture, although the sample is small.

4.5.4 Comparison with experience in rest of East and Southern Africa

The similarities of issues and problems are very striking for example a study in Uganda (Wright et al., 1999) found delayed disbursement of loans, weekly repayment and dislike of the system of attaching savings as major reasons for dropout. These are same issues we found in this study.

A study in Tanzania (Maximambali et al., 1999) found delays in getting access to the first loan, culture of non-payment, loan size, absence of grace period, seasonal trends and diversion of loan funds as major issues affecting dropout rates. As can be seen these issues are very similar to the issues discussed in this report.

A study in Kenya (Kashangaki et al., 1999) found a seasonal pattern in dropouts in rural areas. Our study found a seasonal pattern in both rural and urban areas. The study in Kenya also found that there are clients who join more than one MFI at the same time in order to expand capital base. Our study also found this behaviour among Zambian MFIs clients.

Although the East African studies found very high dropout rates, our study found much higher rates in Zambia.

It is not surprising that there are these similarities; the underlying causes are basically the same. For example, most of the MFIs covered in the East African studies were following solidarity group lending models which are similar to the models in Zambia. In fact, one of the MFIs in the East African studies was also in the Zambian study. Programme policies have significantly contributed to the problem of dropouts.

4.5.5 Initial recommendations

In this section we take the six main findings and provide specific recommendations as well as a few general recommendations. Our findings correlate clearly with the findings of many other researchers in East Africa that studied similar systems. It is clear from these combined findings that the system of group lending as applied by the institutions studied is in essence flawed in the context of the study areas and the clients. The many similar findings with small country specific issues lead to the conclusion that the system as such should also be reconsidered. We do not give attention to this notion in our recommendations, as we did not investigate the complete group based system in the whole of East Africa. We are however convinced that the similar findings are enough justification to question this system.

Specific Recommendations

Loan Disbursement

Delays in loan disbursement is damaging the reputation of MFIs and negatively impacting on sustainability and growth. MFIs should avoid these delays in two ways; for the delays that are due to lack of funds, MFIs must ensure that loan processing (recruitment and training of clients) is done only when funds for lending are assured. Delays due to procedural and other administrative considerations could be minimised by streamlining the relevant systems. In particular, repeat loan approvals should be streamlined to reflect the fact that these relate to clients whom the institutions have some track record of.

Loan Use Reallocation

Diversion of loan funds to other uses such us school fees, health, consumption etc. could be an indication of opportunities for new products[15]. The high incidence of HIV/AIDS in Zambia has worsened the problem of loan use reallocation because of increased number of school going dependants (orphans) and high medical bills. Therefore, MFIs could minimise loan misuse by understanding the financial needs of their clients and respond with demand driven products or more flexible products in terms of what it can be used for. In addition careful selection of clients could minimise loan misuse by preventing undesirable individuals access to loans. This should be attended to in the training of clients before they finalise the choice of fellow group members.

Group Liability (Group Guarantee)

Peer monitoring and joint liability are the corner stones of this group lending methodology. However, the majority of respondents in this study did not like it. They do not like paying for others. To reinforce the group liability, MFIs need to improve client selection and group formation. MFIs must be forthright about the risks associated with peer guarantees. Once again, clients should be sensitised to the importance of selecting the right group members. Also, the opportunity of moving to an individual loan product after the completion of group loan cycles should also be strongly emphasised.

[15] Advise on product development can be found in ***MicroSave***s' product development toolkits – available on www.***MicroSave***.net

Loan Insurance Fund
The problem with LIF is partly one of perception, clients perceive the LIF as a form of a savings account and not as an insurance fund that could be attached in case of a default in the group. But even if people see this as an insurance fund, people do not like seeing their assets being used to cover the default of others. MFIs have two possible strategies. First they could improve the training and information on the functioning of the LIF. Secondly, MFIs could develop separate saving and insurance products. The insurance product could cover group defaults and would be a pure insurance product, thus it will not be paid out. The savings product will therefore also be a pure savings product and this will decrease the confusion. The latter will most definitely address the problem of the desired availability of savings products. However, not all Zambian MFIs are competent and strong enough to offer true savings products and until the new legal frame work is operational this cannot be done.

Weekly Repayment
The weekly repayment schedule fails to take into account the cash flow limitations of most micro businesses and tends to prescribe the type of businesses that can benefit. MFIs should design repayment schedules that take into account the cash flow pattern of the business. An interesting option is that taken by the Ugandan Micro finance Union. They allow their clients to choose their repayment schedule (within certain parameters) and this once again shows that the client's specific circumstances are catered for. However, once a schedule is decided on they keep the client strictly to that repayment schedule.

Loan Amount
The outcry on first and second loans is a genuine concern because of the rapid depreciation of the Kwacha. MFIs should plan loan sizes in real terms, which would imply regular adjustments to the loan amounts to reflect the level of inflation. Quicker loan disbursement and more streamlined systems would most probably be the best solution for this problem. Also, it is important to get the clients to lodge a final application after the six-week's training period as this will accommodate all price changes and loan sizes of applications.

General Recommendations
Customer Service
During the course of this study a substantial number of clients said that they were not happy with the customer services they were receiving, in particular they felt that credit officers were leaving too many issues to be sorted out by group executives. We are aware that clients can and do generalize about an entire organization based on one bad interaction. However, Credit officers must see clients as customers who are paying for the services and give due respect. Staff training in this aspect is desirable and highly recommended. This was indeed echoed by some of the credit officers.

Multiple Borrowing
We found evidence of multiple borrowing; at two occasions we met clients whom we had interviewed in the previous institution.[16] There is an urgent need for MFIs to develop a mechanism of identifying such clients. This provides a good opportunity for co-operation between MFIs that may lead to the business opportunity of running a credit bureau once the market has enough volume. We did note that some of the MFIs are already exchanging information on default clients.

Potential Impact on Product Design
These findings are pointers to the mismatch between market expectations and product design and delivery. The findings therefore, suggest a fundamental review of the product design to make the various products being offered by MFIs in Zambia client responsive. For example this study shows that the first quarter of the year is usually bad for business, possible action would be to design a loan product that offers a 'rest' period during the first quarter of the year and this would most probably have a positive effect on the drop out rate at that time of the year. The task is enormous, but necessary for the growth and sustainability of the MFIs in Zambia.

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[16] Normally this does not become a material problem until the microfinance industry is significantly larger than the one in Zambia. It reflects the present concentration of MFIs in urban areas and especially in Lusaka.

5. Summary of conclusions and recommendations

The purpose of this study was to improve knowledge and understanding of why MFIs in Zambia suffer high levels of dropout (or turn-over) among their clients, and thus to facilitate the MFIs' efforts to address this problem. In this regard we made use of qualitative research techniques to obtain information from clients that will assist our understanding of the dropout problem. The following questions were derived from the research objective.

What are the socio-economic characteristics of dropouts?

We asked focus group participants to define what they thought were the socio-economic classification of MFI clients, and specifically in how they perceive the poverty levels of clients. From the various descriptions a classification emerged. MFI clients can be classified into three classes, namely; relatively better off, managing despite poverty and struggling with poverty. Dropouts came from all these classes, however per session (and thus per area) one could detect a difference. It was clear that although dropouts came from all three categories, most session results indicated dropouts from the struggling class. It seems that they are more inclined to reallocate the loan funds to consumer items, presumably as a result of limited resource base. In the case of the relatively better-off clients it seems that they do not like working in groups particularly with people whom they consider to be of lower social status. Young people are particularly prone to dropout because they are more mobile and are doing business to pass the time while waiting for formal employment. We found clear gender differences; men are more likely to dropout because they do not like to work in groups.

What are the reasons for dropout amongst clients including those that have switched between MFIs?

Although reasons for dropout may vary among clients and institutions, in this study we identified some common reasons as discussed in section 4.5.2 above. These are:

- Delays in loan disbursement
- Loan use reallocation
- Group liability
- LIF
- Weekly repayment
- Loan Amount

What are the reasons why poor people eligible to join MFIs in the areas where they are operating choose not to?

We interviewed ten micro entrepreneurs operating in markets that were serviced by MFIs but had decided not to join and we also asked the above question to the participants of the focus group discussions and PRA sessions. The following were the most common responses:

- MFI money is magical, once you get a loan all your capital will be lost
- We hear from people that MFI would lock you up once you fail to service your loan
- Those who do not join are afraid of weekly repayments

These responses reflect the understanding of people of the systems of the MFIs. It further reflects on the clarity of the MFIs marketing message, and the reputation of the MFI in terms of the treatment of defaulters.

Why would MFI clients join two or more MFIs at the same time?

The focus group discussions and the PRA techniques generated information that confirmed the existence of such people and motivation. We were surprised to note that the practice was established to the extent that clients we met in the previous institution reappeared in another institution. The motivation for dual membership was identified as a desire to increase ones capital base in view of the small loan amounts particularly, first and second loans. And also to access other products, for example one of the clients we spotted in two institutions said she did so because the second institution offers a savings product.

6. Further research questions

In this research study we focused specifically on four questions as outlined in the summary in section five. In addition to these specific questions we looked at whether there are clients staying on in one lending institution even if they are not happy. Responses to this question were all negative, client said that unhappy people would most likely dropout. But this in view of the large number of complaints we heard surprised us. We also examined whether there are clients who move around MFIs "testing" products and we did found some evidence of this occurring.

Our attempts to ascertain the socio-economic characteristics of clients through the FGD techniques were not very successful. We found that Wealth Ranking Techniques are not applicable where you have a very heterogeneous community. Wealth ranking questions in a normal FGD based on a discussion guide leads to very generalised answers.

We made the point of the systemic problems of the group based system as applied in East Africa. We feel that this should be researched, as this is the crux of the problem. Our proposals are based on country specific observations, but surely when you find the same problems in most if not all countries where this system is applied one should start questioning the system.

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