

Improving and Monitoring Customer Retention

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I. Executive Summary

This article discusses the need to fully understand the causes of desertion to develop an effective customer retention strategy. The article provides a framework to improve client retention and proposes an integrated system to monitor the causes of desertion.

The findings and framework of analysis are the result of research on customer satisfaction and desertion undertaken at MFIs in 4 countries - two in South America with a well developed microfinance market, one in Central America, and the other from the Caribbean both with medium developed microfinance market. The key finding is that when customers leave an MFI, generally, they do not go to a competing institution but instead prefer to use their own capital to fund their businesses.

Another key finding is the different causes of client desertion, including factors related to 1) industry structure, 2) MFI management, and 3) customer characteristics. In this article, each dimension is analyzed in detail to develop a retention framework and organize monitoring systems.

Ways in which industry **structure** can cause desertion include:

- a) The existence of a fragmented market where competitors are diverse in size and character which creates fierce competition that can cause current customers to become overly indebted, threatening their sustainability in the long term.
- b) The mismatch between a product that has been designed for under-developed markets and the experienced clients who now are more sophisticated in their financial needs, credit knowledge and usage.
- c) Regional economies that restrain renewal loans for certain client segments.

Causes of desertion due to the **performance of the MFI** can be organized into four factors, which in combination determine customer satisfaction levels:

- a) Satisfaction with the product;
- b) Quality of Customer Service;
- c) MFI image and
- d) Emotional involvement.

Careful analysis of each of these factors reveals major dissatisfaction with product features. Quality of customer service is a complementary source of dissatisfaction, but to a lesser extent, since the emotional connection the customer possesses with the MFI mitigates most weaknesses in customer service.

The final factor to be analyzed is related to **the profile of the customers.** The article shows the importance for a deeper understanding of customer behavior through data segmentation based not only on demographics variables but also with respect to factors that cause desertion such as entrepreneurship intensity, or others described in the article. Segmentation is also necessary to better focus the retention efforts and to identify customers that the MFI would truly need to retain. Also, segmentation is useful to project an acceptable baseline rate of desertion.

Finally, the article outlines the main steps to developing a retention strategy, namely identifying the causes of desertion, **isolating those 20% of causes that cause 80% of desertion**, segmenting the customer base, and prioritizing solutions. The article ends by describing 10 points to consider in the monitoring of retention and desertion.

II. Introduction

The microfinance industry is evolving as a result of competition but also because the experience that the micro entrepreneur has gained through experience using credit.

The study of desertion provides insight into how to improve products and services offered to the targeted market by developing effective retention programs and consequently creating long-term relationships. But why is retention so important? It is not only because *retaining a customer is cheaper than acquiring a new one* or because of the necessity of *retaining customers until they are profitable*. Rather, client retention is important because it is a value generation strategy for the MFI: that is, the MFI's value is not only related to the bottom line of its financial statements but also to the present value of its future revenues. Guaranteeing the MFI's future revenues greatly depends on strengthening its customers' loyalty. For this reason, two MFIs with the same number of customers, the same costs, profitability, and arrears condition may have different values if one of them has more loyal customers than the other. *As such, customer retention is not only necessary for MFI sustainability but it is also a value generation strategy for the shareholders.*

Unfortunately, the microfinance industry is losing customers, mainly as a result of the MFIs' approach, which in many cases focuses on credit sales, expansion and bottom-line results, losing sight that for customers, credit is only a means to satisfy their goals and not an end in and of itself. Moreover, although microcredit has advantages both for the customers and for the expansion of financial markets, microcredit has weaknesses when the market matures and assumes that the customer wishes to be in debt all the time at the current conditions of the product offered.

In addition, when the MFI tries to obtain a higher level of formalization, it centralizes and generates more stringent policies and processes, in an effort to comply with regulatory requirements and minimize its risk. And although

it is imprudent to maintain customers with high risk of delinquency, rigid policies applied in an undifferentiated manner tend to drive away good customers as well as the risky customers.

Finally, competition and the pressure of growth goals make the MFI define a broader market and develop more credit products, with little differentiation among them, diluting its market focus and complicating the administration with limited retention results. Similarly, they emphasize improving customer service, to gain a competitive advantage; yet, this does not necessarily diminish attrition. Given the limited window the MFIs have for innovation, the tendency is to “copy cat” the competition, with all MFIs offering similar products and service levels.

This article differentiates the causes of desertion and analyzes the changing trends in microfinance as markets mature.

Why do customers leave?

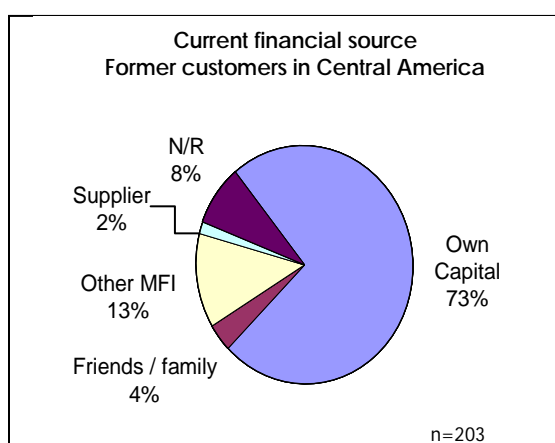
1. Credit does not sufficiently help customers achieve their goals.
2. Customers are being negatively affected and are having difficulties making payments (even though they are not yet in arrears).
3. Customers find alternative forms of financing (or they are self-financed).

Resting customers are not considered deserters, since it is normal conduct for the microentrepreneur to take breaks corresponding to the cyclical condition of its business¹. What indeed does *not* happen is that most customers desert to the competition. Figures #1 A and B present results from market research with former clients of individual and solidarity groups who left the MFI more than one year ago. In these cases, a large portion of ex-clients are using their own capital to manage their businesses. In the first case, a moderately developed market in Central America, only 13% of former

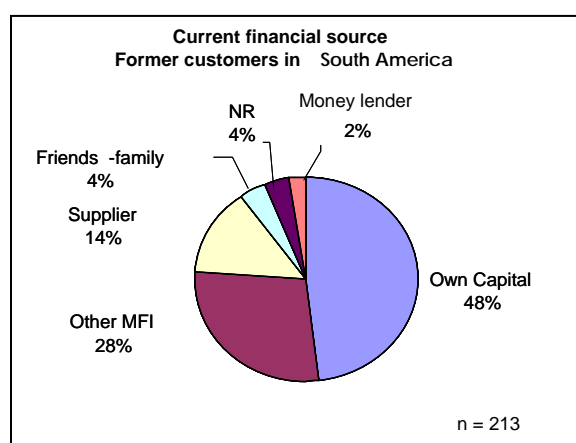
¹ Resting clients refers to clients who do not immediately renew their loans, a postponement. This resting time is financial “downtime” for the MFI because it does not earn any income from the client during this period. The Challenges of Measuring - Customer Retention, Waterfield, p.5

clients went to another MFI. The remaining 73% are now using their own capital to finance their business. In the second case, despite the well developed market and high competition in a MFI in South American country, only 28% of former clients went to another MFI, almost 50% were not using other credit sources. These figures are similar to the results of the investigation presented by Katarzyna Pawlak in a study by the Microfinance Centre,² which suggests that customers going to another MFI were between only 13% and 15%.

Graph # 1-A



Graph # 1-B



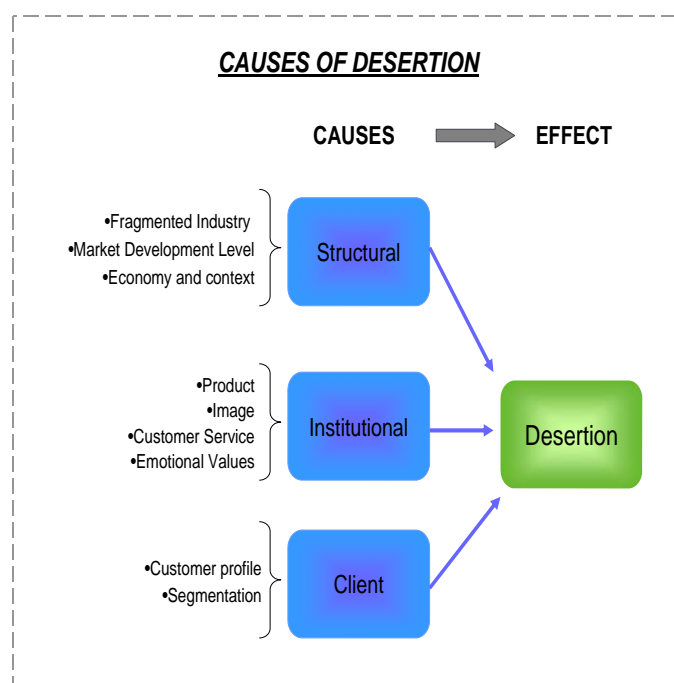
Source: Quantitative Market Research led by ACCION International, Market Intelligence Unit, 2004 and 2005.

² Pawlak, Katarzyna and Selma Jahi; Promoting Customer-focused Organization; Spotlight Note 9; MFC; p.6

III. Causes of Desertion

To improve retention, an MFI needs to first of all review the causes of desertion. The causes of desertion are numerous and sometimes inter-related. To study them in greater detail and see their relative importance, this article analyzes them separately. Diagram 1 shows the general framework of analysis.

Diagram #1



1. Desertion due to industry structure

a. Growing competition as a result of low entry barriers create a fragmented market with numerous and diverse competitors.

In general, the microcredit industry operates in fragmented markets, in which diverse participants in nature and size compete; as a result, the market share of each MFI is diluted. A clear example of this is Ecuador, where a village bank model, two specialized microfinance banks, cooperatives, and the largest bank in Ecuador under a service company model³, compete in the same target market.

In fragmented markets, even market leaders fail to reach even 30% market participation, as is the case in the microfinance industry.

A small MFI may compete with a larger MFI, since they may not have significant cost disadvantages considering 1) the high level of

³ Service company model is an approach used by ACCION International to allow traditional banks to enter microfinance with limited risk and cost by creating a non-financial organization to handle all specialized microcredit issues while leveraging the bank infrastructure and capital.

personalized service that is, in general, used throughout the industry which is difficult to automate⁴ or scale up and 2) the very local clients' business operations that reduces the positional advantage of MFIs which possess a wide branch network since customers rarely use outside locations. The MFIs geographical coverage is advantageous for portfolio growth, yet it does not represent a differential advantage for the customers. Accordingly, large and small MFIs are able to compete in relatively equal conditions in their geographically localized markets since they have the same relative cost in the major expense component: Human Resources.

Moreover, having a credit evaluation methodology is not an entry barrier for new competitors since it is based on the expertise of its human resources, which can be captured by a new entrant by hiring away the competing MFI's staff. Indeed, this aggressive competitive strategy is taking place, evidenced by high levels of loan officer turnover in the microfinance industry.

The aforementioned factors cause the microcredit market to become strongly competitive. Unfortunately, what should be healthy for free market development in which the greatest beneficiary of such competition should be the customer instead becomes a cause for over-indebtedness, delinquency, and customer desertion if it is not managed with a customer-driven philosophy.

Though these overly competitive markets might benefit from industry consolidation, there are other factors that preclude it, such as:

- Low industry entry requirements (in terms of minimum capital or legal hurdles especially to establish an NGO).
- No need to have a well-recognized brand name to offer credit.

⁴ Technologies such as the application of credit scoring, WAP technology for mobile telephones or the ®Portacredit software available in PDAs may help overcoming fragmentation. However, these, as well as the necessary investment, are not available for most MFI.

- Personal and professional goals behind many MFI's (at a director, manager, donor, and investor level), rejecting mergers with other MFIs.
- Some MFIs' missions envision credit as a supplement to other social purposes such as health, education, women empowerment, etc., so that reaching scale is not a priority.

Therefore, it is expected that strong competition will continue until the technology will be available to scale up the market and the main causes of the fragmentation can be overcome.

b. Product and market adequacy.

The basic microfinance model assumes a market that has to be developed, i.e. potential customers do not know the benefits of credit and that they have to be trained through an almost missionary activity where the loan officer visits nearby small towns. The implication of these conditions is that the customer is not profitable after the first credit but from subsequent ones, to recover expenses incurred in their financial education. However, in the mature markets studied, customers have learned rapidly about the operation, convenience, advantages, and disadvantages of credit. Many potential and current customers are well informed about the existence of the credit offer, also having established an attitude towards credit. In some countries, the "first credit buyers" market is being depleted, and customers go by themselves looking for a better value proposition or simply electing to not use formal credit.

The basic credit product proposition, with stepped lending amounts, does not fit with the client that has already learned and evolved in his/her credit needs. Accordingly, MFIs looking for new markets turn to segments with lower income or higher risk, where microcredit is not necessarily the most adequate product, resulting in high attrition levels due to the lack of sustainability that small loans produce or due the vulnerability of customers being approached.

c. Regional Economic Factors.

The microentrepreneur's regional economy also commonly influences desertion (or resting). This factor is related to the intuitive projection that the micro-entrepreneur makes on his or her future sales. The regional economy is an essential consideration in the decision to renew credit, regardless of the quality of the credit offer.

Although micro-entrepreneurs are capable of overcoming unemployment and managing economic fluctuations, not all of them have the same proclivity towards risk, which is related to their self-perception of capacity to handle these challenges. It should not be taken for granted that microentrepreneurs depend entirely on the loan officer's assessment to project their future payment capacity upon applying for credit renewal. The so-called "resting times" that occurs when the customer prefers to wait before taking a new credit, is the common effect of this circumstance.

The Consumer Confidence Index⁵ is sometimes used by consumer financial institutions as an indicator to project future sales, based on the likelihood of credit renewal or expansion of the credit portfolio. A segmented confidence index for self-employed population or retail customers with lower income is frequently tracked in Latin American countries.

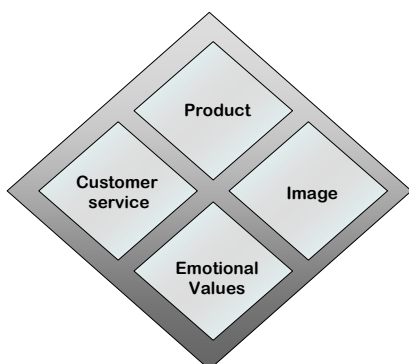
2. Desertion generated by MFI performance

The reasons for desertion resulting from MFI performance are related to the value proposition it offers its customers. The satisfaction components that ACCION uses to analyze are shown in Diagram #2. In addition, Figure #2 shows results of quantitative studies on the customer level of satisfaction in two MFIs.

⁵ Confidence Index measures how optimistic or pessimistic consumers are with respect to the economy in the near future. Usually it is measured by government entities or market research companies.

Diagram #2

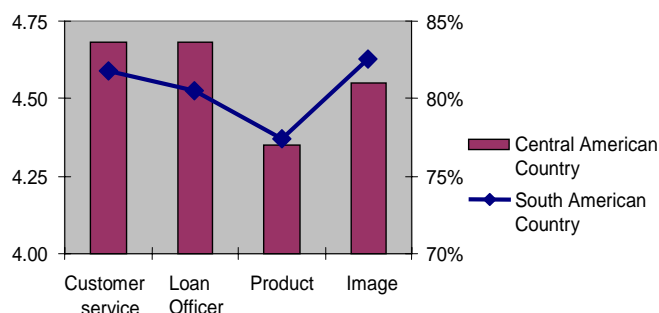
Components of Loyalty in Microfinance



Source: f Loyalty Elements in MFIs, Marketing & Product Development Unit; ACCION Int, 2005

Graphic #2

Comparison of Satisfaction Level



Source: Customer Satisfaction Research led by ACCION Int. 2004 and 2005

In both cases, the lowest satisfaction level was related to product features and, as is to be expected, emotional values have the strongest satisfaction level due to the personalized service that the MFIs give to their customers.

a. Satisfaction with microcredit product features.

The market research of the MFI uncovered the following issues related to dissatisfaction with the microcredit product features.

- **Model centered around a single product: Credit for micro-businesses.** The single-product approach results in processes and a culture that make the offer inflexible⁶ and limited in reach. Considering the nature of the micro-entrepreneur's activity, *flexibility is one key element to promoting client retention.*
- **Credit product perceived as standard.** Customers perceive that price, amounts, and the methodology (accessibility) are more or less the same among the operating MFIs. The new product developments have limited innovations and add little value to the customer, however complicated the MFI control and operation.

⁶ Products are rigid in terms of credit use, maximum amounts, fixed repayments, and undifferentiated interest rate regardless of the customer profile.

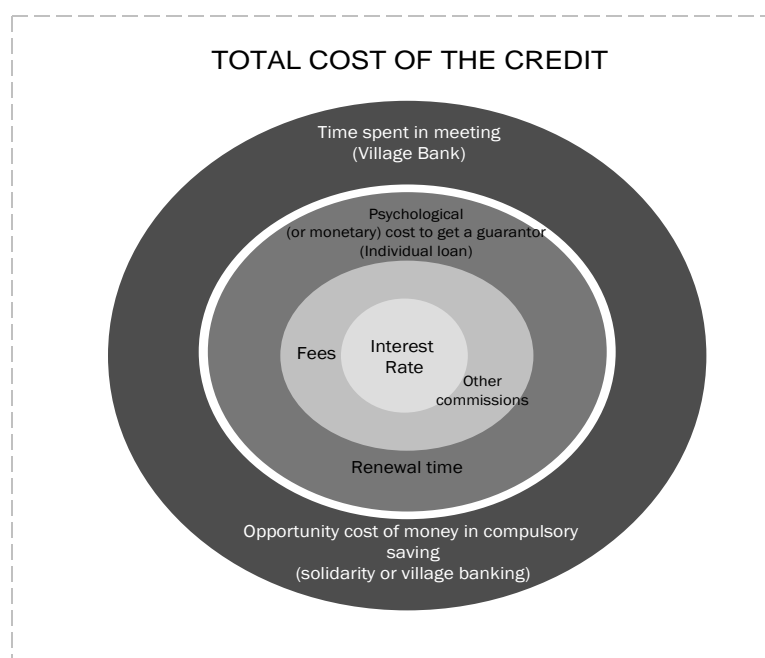
- **It is no longer accessibility, but flexibility.** In countries where the subject of desertion has been studied and where credit bureaus are deployed, it was found that between 35% and 50% of customers alternate or use, in parallel, more than one formal microcredit provider. This phenomenon of parallel credit, illustrates that the market generates its own alternatives, without waiting for the MFI to adjust its credit policies.
- **Amount and term.** For certain segments, the amount and the term are more important than the interest rate, since having a greater loan amount for working capital allows them to dilute their business' fixed costs more quickly. Also the longer term allows them to reduce renewal costs.⁷
- In some cases there is also **extreme precaution by the loan officers** to reduce the amount the customer may access in order to assure the payment. Ironically, however, customers requiring additional amounts will look for other credit providers, increasing the institution's risk.
- Also, the research in a Central American country revealed different correlation with some customer service satisfaction issues depending on the loan amount. The higher the amount, the lower the satisfaction with "service hours" and "service speed" and also more demands for other financial services as well as fewer requirements of other related services such as training. This shows us how important it is to fine-tune the target and align the capacities of the MFI to the market being targeted.
- **Interest rate and total price.** Micro-entrepreneurs, being businesspeople, try to optimize their costs, subconsciously or consciously, so that ultimately, the MFI *value proposition* is translated

⁷ Renewal costs include commissions for new disbursements, additional time required for signing documents, securing guarantors, waiting times for payments to be made and other transaction-related expenses.

into a *total price* to the customer. Qualitative and quantitative market research shows that the interest rate only has less importance in front of other features that also have related costs, such as loan amount, term and frequency, as shown in Graph#3 A and B. Moreover, as the differences between Graph#3 A and B illustrate, interest rate has greater importance in MFI 2 where the market is highly competitive and for the segment with the higher income level (like those for individual lending). Nonetheless, interest rate is not the dominant driver of desertion, relative to other costs, as shown in diagram #3 regarding the Total Price to the client

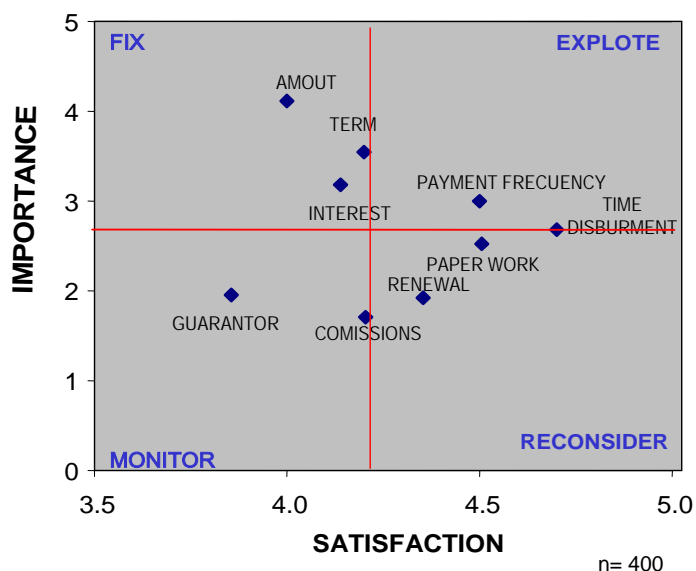
- Although, lowering the interest rate for the best customers has been demonstrated to be an effective short term retention tactic. For now it is complicated to reward customers with good payment behavior with a lower interest rate, since the budgets and projections of most MFIs work with average pricing, which creates constraints on offering price discounts without negatively impacting MFI income. In fact, MFIs are very inelastic in terms of decreasing interest rates, unless there exists an institutional commitment for improving efficiency and transfer those gains to the clients or the competition forces this efficiency.

Diagram # 3

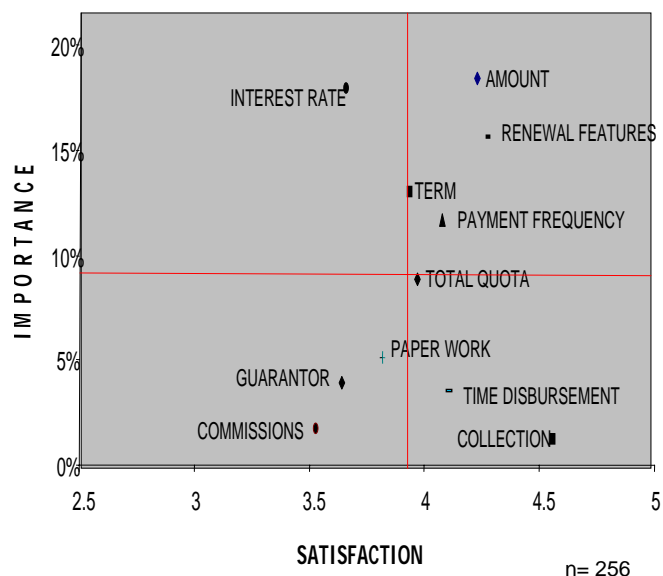


The following graphs #3 A and B show customer satisfaction versus importance of credit product features as a result of two quantitative surveys made with solidarity and individual loans customer in a Central American country and another in a South American country with individual loan customers.

Graph #3A: Product Satisfaction Central America MFI



Graph #3B Product Satisfaction - South America MFI



Source: Customer Satisfaction Market Research led by ACCION Int, 2004 y 2005

b. Satisfaction with Customer Service

Though the MF industry still has a lot of ground to cover with respect to improving customer service, since MFI customers have lower expectations about service this makes it a less important cause for desertion. In addition, the personalization and emotional involvement of the customer frequently replaces the service weaknesses of the MFI.

Substantial improvement in customer service in most cases requires significant investments in infrastructure, such as speedy IT systems, alternative channels for more convenience, bigger branches, which the MFIs often do not have the resources to build in the short term. Other customer

service initiatives, not related to infrastructure, are easy to copy - such as the suggestions box, line organizer, front office customer service training, gadgets, etc., and as such these actions do not represent a competitive strategy by itself, being rather a complement to other strategies.

Various sources indicate that customer service is not the main factor for desertion, such as the research undertaken by Inez Murray⁸ which shows that, in Bangladesh, desertion for service-related reasons represented only 3% of the stated cause for desertion, as opposed to another investigation made in Uganda, where this percentage was 9%.

Research done by ACCION International similarly illustrates that poor service is not an important driver of client desertion. In the case of the MFIs studied in Central America, it was found that only 3% of desertion was due to service issues, and it was 10% in the MFI in South America. Nevertheless, improving customer service is essential to permit the MFI to accomplish its social mission, balancing the Customer-MFI relationship: going from a LOSE-WIN to a WIN-WIN perceived relationship will establish the basis for loyalty.

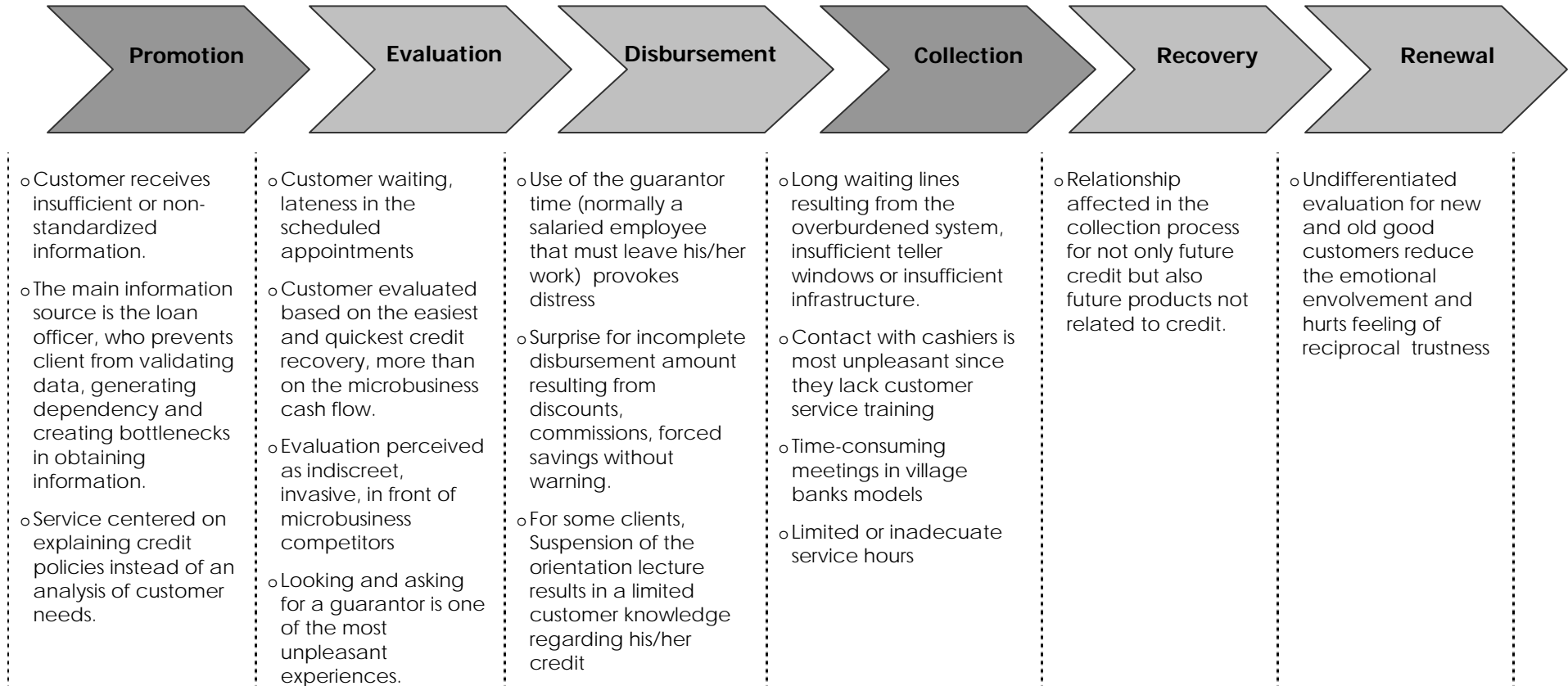
The customer experience in the MFI. Analyzing critical contact points in the MFIs studied revealed important improvements with respect to the accessibility and speed in credit evaluation and disbursement; however, there are still critical issues that have to be improved, basically related to the promotion and collection phases.

Diagram #5 shows a summary of the credit processes and contact points that result in dissatisfaction in a customer's experience. The dark arrows indicate phases that are generating the greatest dissatisfaction. Certainly, not all contact points are equally weak in all MFIs.

⁸ See Cultivating Customer Loyalty: Exit Interview from Africa and Asia, Inez Murray, Microbanking Bulletin, April 2001, p.22.

THE MICROFINANCE CUSTOMER EXPERIENCE

(Shows only contact points subject to improvement)



c. Desertion caused by Microfinance Institution Image

Brand strategy is a factor that receives minimal attention in the MF industry given that a strong or renowned brand is not a key element for offering credit. It becomes relevant once the MFI tries to enter into other markets such as the savings or insurance market or when faced with retention problems in some market segments.

Image of “small” and “credit-focused”. In many cases, positioning of MFIs as small or low-tech leads some customer segments to view the MFI as a temporary solution, or to use the institution for a specific need. Since the MFIs are positioned as a credit provider, the customers do not foresee a relationship beyond that. Both banks, for their solidness, and cooperatives, for their permanence in time and the sense of belonging they provide, have images that encourage loyalty more than the MFIs do. As such, this is an issue that the MFIs must take into account, despite not having future conversion plans.

Focus group for image in Brazil *"is too small to stay here"*.

Focus group for image in Guatemala *"we cannot ask them for more"*.

Generally, MFIs are positioned as a credit provider and play a decent role in their category, i.e. among all MFIs granting credit. However, while the institution is being more regulated or starts to increase its services portfolio with something other than credit products, it risks losing proximity and positioning in its target market. As such, many MFIs have found that their customers obtain loans from them but save in their cooperatives or in banks. Maintaining the close relationship with the client is the MFI's main strength; sustaining this proximity when competing with other categories (like savings) is one of the great challenges that the MFIs will face.

d. Customer emotional connection is still the best success factor for retention in the MFI

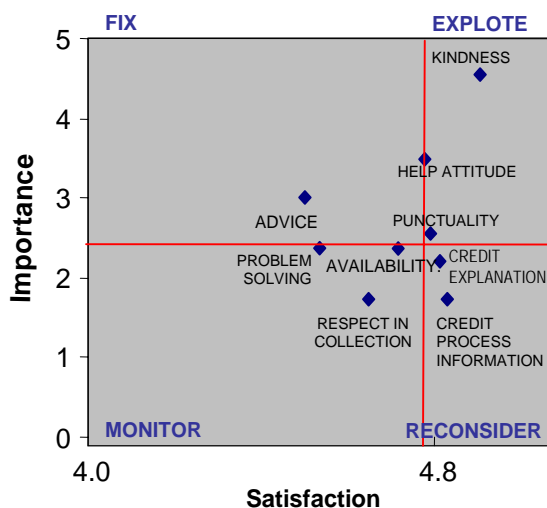
The customer tolerates much of the MFI's customer service weakness due to his/her emotional bond with the MFI and staff. Loyalty is based on emotions,

which is why it is important to identify their emotional needs: *emotional value is literally the economic value of feelings.*

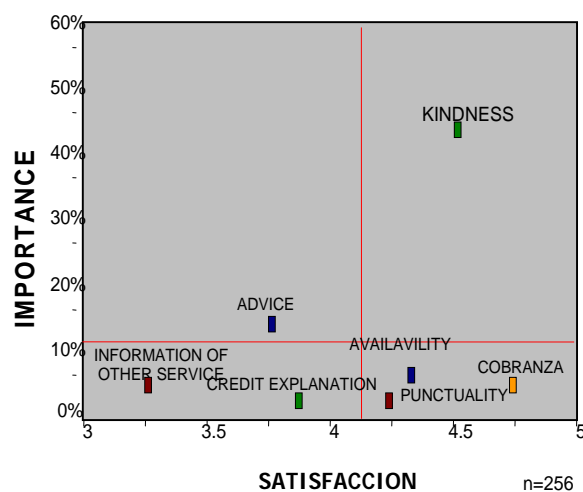
Also, the loan officer is still an essential part of this relationship, since the inactive customer does not feel like a former customer, since his/her loan officer remains in the MFI, so both customer and loan officer are critical components of retention.

However, there are still areas of improvement in this satisfaction component, which recurrently appear in satisfaction research - both qualitative and quantitative – these are the advisory capacity of the loan officer, his/her punctuality and the quality of the information given. Figures #4 A and B show some of these results. The advisory capacity suggests the importance of helping improve the efficiency and solvency of a microenterprise, instead of just focusing efforts on credit renewal. The more efficient the microentrepreneur is, the better the microfinance market will be. For the loan officer, these are the greatest challenges to improving retention.

Graph # 4-A – IMF IN Central America



Graph # 4-B – IMF in South America



Source: Customer Satisfaction Market Research led by ACCION Int, 2004 y 2005

Desertion due the MFI policies

Customers with potential payment problems are, in general, rejected for loan renewals. Research undertaken with former customers of individual loans indicates that customers, who were rejected by their own loan officer or

because of a MFI policy, account for between 12% and 15% of the desertion. In addition, Kim Wilson⁹ shows a chart of a MFI where involuntary desertion (due to delinquency issues) was about 13%.

Many MFI incentive systems penalize loan officers for their delinquent accounts, leading them to be more conservative in accepting renewals. The research done in a Central American country with solidarity and individual loans indicates that 2 out of 5 former customers left involuntarily based on the group or loan officer decision.

As indicated below, it is recommendable when monitoring desertion to adjust the rate to account for involuntary client desertion by registering those who leave as a result of being rejected by MFI policies.

3. Desertion due to the characteristics of micro-entrepreneurs

Many MFIs take for granted their customers *need* credit to grow or to be successful. However, given the customer's nature and microcredit characteristics, this is not always true. Microentrepreneurs have a variety of financial needs such as insurance or savings, or others such as training, networking, business advisory services and related micro business services.

It is frequently overlooked that, for the customer, *credit is a means and not an end in and of itself*. Customers do not seek credit as such: rather they are looking for solutions to their needs. For example, an appliance store that helps the client finance the purchase through interest-bearing installment payments is selling solutions.

Customers have diverse attitudes towards the credit, different personal and family goals, different entrepreneurial capacity, etc., so understanding the segments being served is important in order to know who the customer of the current value proposition would match better, so that there will be fewer desertions. Considering that goals drive peoples' behavior, fully

⁹ Exodus: Why customers leave, Microbanking Bulletin, April 2001

understanding them, as well as existing segments and their decision-making process, is a basic element for developing an effective retention strategy.

a. Segmentation variables related to desertion.

Customers may be analyzed from various perspectives, called segmentation variables. In the case of desertion, it is important to note that segmentation variables must be based not only on elements related to credit (for instance resting customers, delinquent customers), but also on behavior patterns and psychographic (i.e. life style) segmentation that will provide in-depth insight as to the reasons for desertion. These critical consumer insights allow for the generation of more effective and focused solution alternatives.

There are diverse information sources that can help identify the relevant segments. Below is an approach employed to identify segmentation variables affecting desertion based on primary market research, secondary sources, MFI data mining, expert opinions, field experience, and anecdotal information. Six perspectives or segmentation variables – shown in the table below - were identified that seemed to impact retention. ACCION is also working with more rigorous statistical models, including a desertion score card to determine the probability of desertion based on the customer profile.

Segmentation Variables Involved in Retention

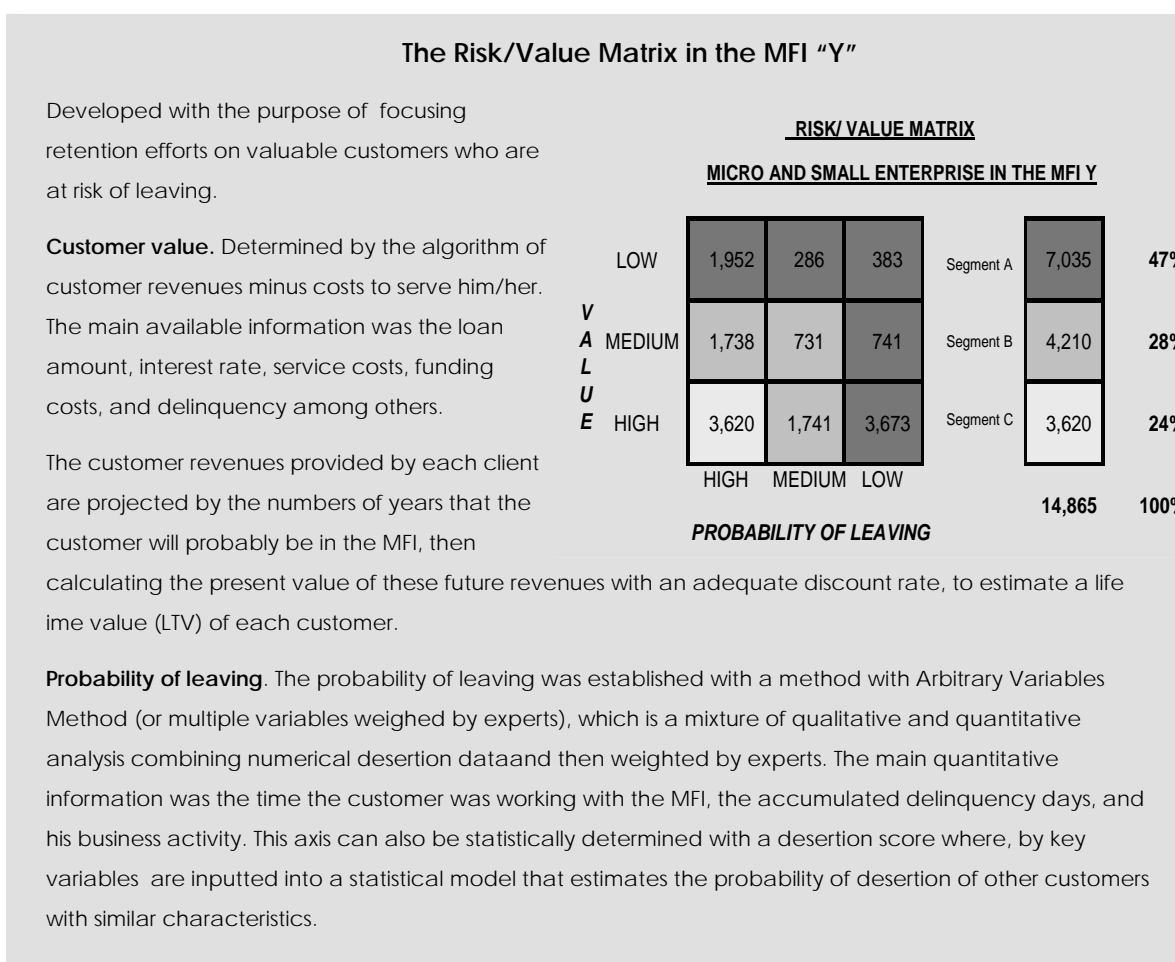
An approach

Customer should be analyze by ...

1. Stability of family income
2. Microbusiness level income
3. Attitude toward the loans
4. Age and experience as a micro-entrepreneur
5. Enterprenourship intensity
6. Specifics goals when being MFI customer

Who should be retained?

Most MFIs wish to retain all their customers, without discrimination. However, considering that they must efficiently use their resources, focus is required to retain better customers who are at risk of leaving. In choosing how to focus its efforts on, the MFI faces the dilemma of identifying who the most "valuable customers" are - the most profitable customers or the poorest (the MFIs' mission). The risk/value matrix shown below illustrates a segmentation combining these variables.



Below are some considerations that should be factored in when deciding whom to retain as a priority:

1. **Strategic importance:** Opinion leaders, those belonging to the segment that fits well with the competencies of the MFI, or other potential growth segments.

2. **Profitability:** Customer relevance often follows the “Pareto” rule, whereby 20% of the customers provide for 80% of profitability. It is important to differentiate whom to retain versus whom to reward. Retention and rewarding strategies are not equal. One could be necessary, the other being optional.
3. **Loyalty:** Some customers are inherently more loyal than others, for reasons having to do with their profiles rather than something attributable to the MFI (e.g. young micro-entrepreneurs tend to test more options before staying with one).
4. **Life Time Value (LTV):** The discounted present value of future revenues that the customer would give to the MFI should he/she decide to stay, i.e. since the customer value is measured with respect to its future sale potential and not the current potential. It should be noted that not all MFIs have information on customer related costs, so that proxies could be obtained while adequate information is captured on issues such as desertion.

IV. Monitoring the retention

In measuring performance with respect to client retention, it is important to distinguish between *monitoring* (continuous measurement) and other basic forms of information gathering related to market research (undertaken at a specific point in time). In both cases, more important than the method of measurement is to define *what is going to be done with the results*.

Collecting information on consumer behavior and/or reasons for desertion causes from exit interviews or suggestion boxes, for example, are useless if these are not supported by a market intelligence system that would permit it to flow through and analysis at a strategic decision level. Repeatedly in ACCION's work on desertion, the same suggestions or causes surface month after month since the root causes have not been addressed. Moreover, the reasons for desertion do not substantially vary over time because customers' behavior and attitudes develop over time and therefore do not change quickly. Sometimes these never do¹⁰.

Most MFIs do not have enough staff resources or technological infrastructure to carry out continual tracking techniques – like exit interviews. For this reason, market research efforts are a good alternative to analyze issues relating to desertion instead of regular monitoring of data will not provide new information

Some MFIs have considered investing in sophisticated information systems – like customer relationship management (CRM) programs,

which use data warehouses to mine information about clients. Nevertheless,

Market research versus desertion monitoring

What is researched? Reasons for exit including external causes outside the MFI control, such as: competition market penetration, customer profile, MFI image, and the decision-making process pertaining to leaving, among others. The purpose of the investigation is diagnosis

What is monitored? The effects of modifying a root cause. For example, wait time for payment after changing the teller software. The idea of monitoring is to measure the impact and effectiveness of addressing a desertion driver. Monitoring ensures that retention measures are targeted at root causes.

¹⁰ People's tendency to maintain their initial opinions are part of basic human psychology – such as cognitive dissonance, the tendency to discount information that contradicts existing beliefs.

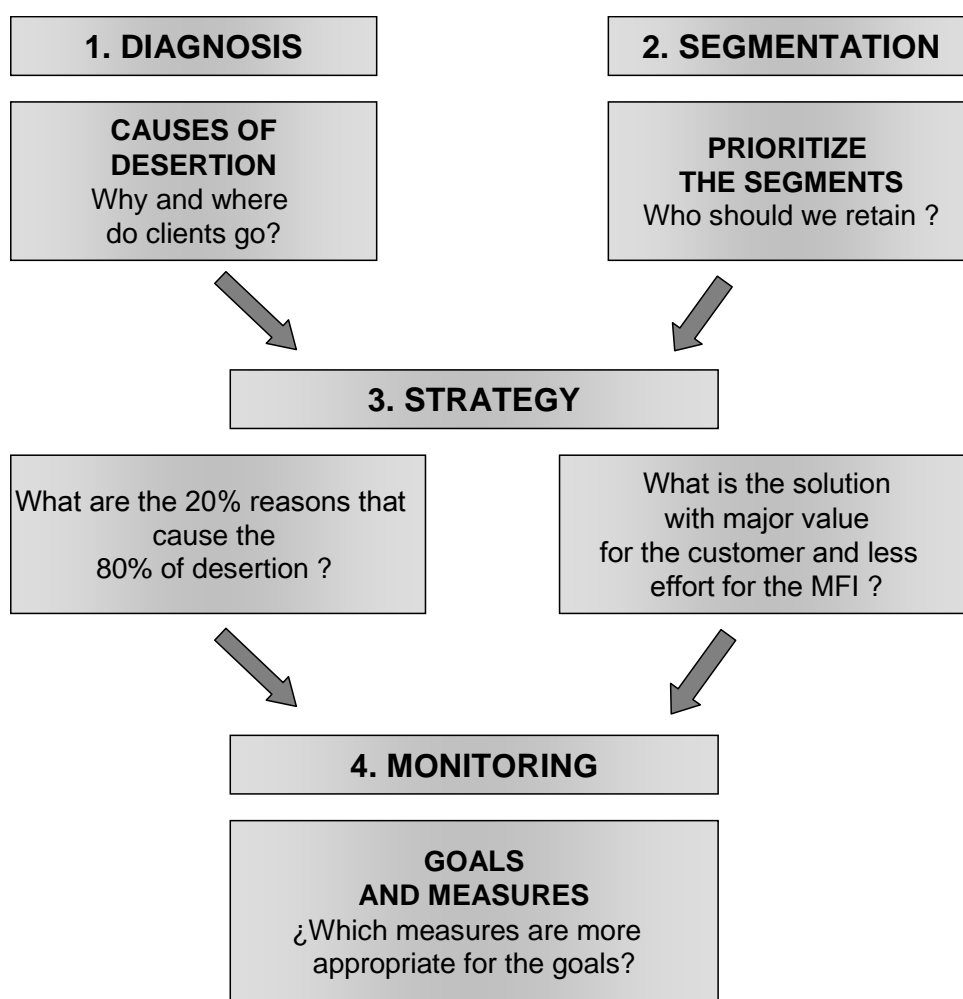
the time required for these long-term projects can hinder short-term decision-making. Determined actions to address retention issues are more important than investing in sophisticated information systems.

1.The retention improvement process.

ACCION International uses a systematic process to address retention that is depicted in Diagram # 6 Annex A provides additional information in such framework.

Diagram #6

Framework Retention Improvement



Source: Retention Management Framework, Marketing & Product Development Unit, ACCION International

2. Retention and desertion formulas.

There is no standard formula for measuring desertion or retention, due not only to the different variables collected by each MFI, but also due to the difficulty of standardize information within each MFI. The bibliography references the diversity of formulas that have been proposed to measure retention. Some MFIs adopt such formulas, while yet others use their own, designed according to their needs and the available information. Excellent discussion of alternative retention measures can be found in "Talking about performance ratios", in which Richard Rosenberg mentions the advantages and disadvantages of each formula¹¹, or "The Challenges of Measuring - Customer Retention" in which Chuck Waterfield mentions the evolution of the formulas and analyzes their application while taking into account *resting* times.¹²

It is worth highlighting some key elements regarding the application of the desertion or retention formulas:

- **More important than selecting a particular formula is developing solid reasoning** behind the formula chosen and understanding its implications, so that the MFI will be able to properly interpret the results.
- **The terms "desertion" and "retention" are not necessarily polar opposites of each other** (i.e., the desertion index does NOT equal 1- retention index), as deserting customers are those who will not return to the MFI in the future, rather than those who do not renew today.
- **Analyze trends over time and put the results in perspective.** For strategic management of the desertion, it is not only important to monitor the retention and desertion index, it is also necessary to

¹¹ Talking about performance ratios, Measuring Customer Retention by Richard Rosenberg; The Microbanking Bulletin, Issue #. 6 April 2001.

¹² The Challenges of Measuring - Customer Retention by Chuck Waterfield, The Practitioner Learning Program Technical Note #2, Seep Network, 2006.

Full references for both articles can be found in the bibliography and are available for download on the web.

monitor the factors that are causing desertion in order to have an effective control over retention.

- **Consider separating out those clients rejected by MFI policies in order to have an effective formula since the cause of leaving are particularly different.** Even than the current formulas serve well for costing process, but for decision-making process in handling desertion; adjustments need to be made (see an exercise)
- **A single formula cannot consider all facts involved, nor serve all purposes.** Consider having more than one formula to measure the retention and desertion or combine taking into account client resting segment for example.

Adjusting the Desertion Rate Considering Rejected Customers

Below an ACCION International formula and a proposal to adjust a customer rejected by the MFI (*)

DR: Desertion rate.

EDR: Effective desertion rate, eliminating customers having left due to MFI policies

N: New client in period of analysis

CA_{ini}: Active clients at the beginning of the analyze period

CA_{fin}: Active clients at the end of the analyze period

CR: Client rejected for renewal during the analyzed period

$$DR = \frac{(CA_{ini} + N - CA_{fin})}{(CA_{ini} + CA_{fin})/2} \quad \quad EDR = \frac{(CA_{ini} + N - CA_{fin} - CR)}{(CA_{ini} + CA_{fin})/2}$$

Example:

N: In June 278

CA_{ini}: 1st June 6,276

CA_{FIN}: 30th June 6,100

CR: In June 90



DR: 7% in June = 430 customers

EDR: 6% in June = 370 customers

Also, if the MFI offers various products (for instant savings), the TD formula can also be adjusted to calculate desertion of the entire customer portfolio, since it considers the number of clients instead of number of credits. This is an example for only one product analysis.

(*) A few MFIs do register the rejection in its information system, but it is encouraged to do so as the result has variation over time.

Monitoring Client Resting Times.

As has already been mentioned, resting times are not considered desertion, given the activities most frequently financed by microcredit, such as commerce; thus, for retention purposes it is better to separate inactive customers from those truly being former customers.

The following chart shows the result of a segmentation of inactive customers, based on the time they left the MFI versus the time spent in their MFI. The proposed behavioral¹³ segments show that 1 out of 6 inactive customers would still be customers of MFI A, while 1 out of 4 customers would be customers of MFI B.

Segments in Inactive Customer

Segment	Discriminator	MFI A Central America	MFI B South America
Still customers	More than two years as a customer, the last payment was less than one year ago	15%	25%
Dreadful loss	More than two years with the MFI, the last payment was since more than one year ago	30%	60%
Trailer customers	A loss; did not want or could not maintain the credit. Less than two years as a customer, the last payment was more than one year ago	30%	12%
Uncertain customers	less than two years years as a customer , the last payment was less than one year ago	25%	3%
Sample		261	277

Source: Source: Retention Market Research led by ACCION Int, 2004 y 2005

Katarzyna Pawlak¹⁴ in MFC Spotlight Note #9 divides the customer base into 9 segments based on the last payment and the customer status (active or inactive). Segments are: frequent user, resting, deserter, potential frequent user, potential resting customer, and potential deserter.

¹³ Behavioral segmentation refers to divide the customer in different groups on the basis of knowledge of, attitude toward, use of, or response to an offer.

¹⁴ Pawlak, Katarzyna and Selma Jahic; Promoting Customer-focused Organization – Partner's Exit Monitoring System; MFC Spotlight Note # 9; Microfinance centre.

In addition, Chuck Waterfield also worked on this same issue in his recent publication "The Challenges of Measuring Customer Retention"¹⁵, where he proposes 4 segments (regular customers, resting customers, possible deserters, confirmed deserters) and suggests applying the formula separately to each segment.

All these approaches lead to the same conclusion: The length of time the customer left is a basic discriminator to determine the "desertion" type. So the MFIs must consider this issue as an important guideline for their retention strategy and consequently a monitor variable.

¹⁵ The Challenges of Measuring - Customer Retention by Chuck Waterfield, The Practitioner Learning Program, Putting Customer Assessment to Work, Technical Note #2, Seep Network, 2006.

3. Main Measurements Related to Retention

In determining how to monitor client retention, the MFI must take into account the different dimensions impacting client retention. Also, monitoring depends on the goals of the MFI's retention strategy. The following chart is the summary of useful indicators related to retention.

Useful Measures Related to Retention

Dimension	Index	Criteria	Example	Source
Context	Consumer confidence index	Perception of ... = 1 → The economy will stay the same < 1 → The economy will be worst > 1 → The economy will be better	0.67	Government sources, Economic publications.
Institutional	Products per client	The more product or services per client has the more exit barriers will be	1.1	MFI
	Renewal pre-paying the current credit	Renewal using pre-paid system (where final installments are financed by the loan renewal) is not a sustainable retention strategy. This strategy must be evaluated while it is measured. Clients renewing via prepaid / total renewed credit	5%	MFI
	Customer Rejected	Customer rejected in period x / Total clients in period x + Customer rejected in period	9%	MFI
	Over-debthness	Active clients with more than two formal credit provider/total active clients	30%	MFI and credit bureau
Customer	Arrears	(Active clients with PAR > 30 / total active clients) X 100	3.5%	MFI
	Resting clients	Maximun number of client likely resting (Inactives clients for less than 1 year /active clients + inactive clients for less than 1 year) X 100	25%	MFI
Results	Renewal Index	Client renewing in period x /total active clients in period x	85%	MFI
	Effective Desertion index (Considering those who were rejected)	$EDR = \frac{(CA_{ini} + N - CA_{fin} - CR)}{(CA_{ini} + CA_{fin})/2}$ Consider the use of moving average of the last 12 months to fine tune the measurements of the clients who are temporarily resting.	5%	MFI

Considerations in the measurement process.

The following 10 considerations are recommended to establish benchmarks and baselines for retention measurement.

1. **Set a target.** What is the number you wish to reach? If you do not have a goal, then why monitor? (E.g., In Christmas campaign should return at least 75% of resting customers).
2. **Observe the curve and not the measurement itself.** The curve indicates trends; an isolated number shows only one piece of information that could be contingent on other factors or temporary.
3. **Apply the Pareto principle¹⁶ as a general rule.** Recognize that 20% of the customers contribute to 80% of the profits, or which 20% of the causes are resulting in 80% of the complaints or desertion, etc.
4. **Use absolute numbers as well as percentages.** The percentage, being relative, must be supplemented with the factual value in numbers (e.g., indicate that a 15% desertion is the equivalent 3,500 customers).
5. **Shortening the measurement period lowers the desertion index.** To avoid underestimating the amount of desertion, make the measurement period equivalent to the longest credit term of the MFI (e.g. 18 months), as the strictest test for desertion.
6. **Provide one year for your customers to return, allowing you to consider them desertions.** Otherwise, use a different time for the index, since business cycles are in general last one time a year (New Year's Eve, Mothers day, back to school day, etc.). Consider changing the status of inactive customers to former customers after this time.
7. **Use moving averages to eliminate temporality and see the tendencies** E.g. The average of the previous 12 months have to be

¹⁶ The Pareto principle (few vital, many trivial) indicates that there are many unimportant problems versus just a few serious problems. The principle mentions the 20/80 relationship that says that, in general, 80% of total results come from 20% of the related elements.

measured on a monthly basis, thereby removing the seasonal desertion and considering that most customers had at least the chance not to renew during the last 12 months.

8. **Define desertion in terms of customers and not products.** If you have more than one product or service such as insurance, savings, or training, include the use of all products in the desertion index and not just credit products.
9. **Make measurements in the same time.** To allow valid comparisons, use the same time period (be it day, week, month, or quarter). For instance, make measurements in the first week of May, and then the first week of June.
10. **Use neutral parties to conduct research instead of MFI staff.** The emotional connection and involvement with customers affect the responses given regarding causes of desertion, compromising the objectivity and reliability of the information gathered.

V. Conclusions

The desertion endemic throughout the microfinance industry is a forewarning about the mismatch between the value offer delivered by the MFIs and the objectives of the micro entrepreneurs. The majority of former clients are not going to the competition nor are they resting, which suggests the causes have to do with industry weaknesses that will not be fixed by just letting all the players compete. Rather, dual measures are necessary: adjustments in market target as well as the value offer delivered.

It is important to keep in mind that successful micro entrepreneurs are people who choose financing options based on the relative cost/ benefit of any offer. Their intuitive rationale takes into consideration the convenience of credit renewal.

Research shows dissatisfaction issues are more related to core credit features that are ultimately translated in the total effective price. For improved retention, customer services features are less important than improving the core product features.

For an MFI to be customer-driven, it is essential to segment the market. Segmentation becomes a key tool to be efficient in the big market of the informal microentrepreneur.

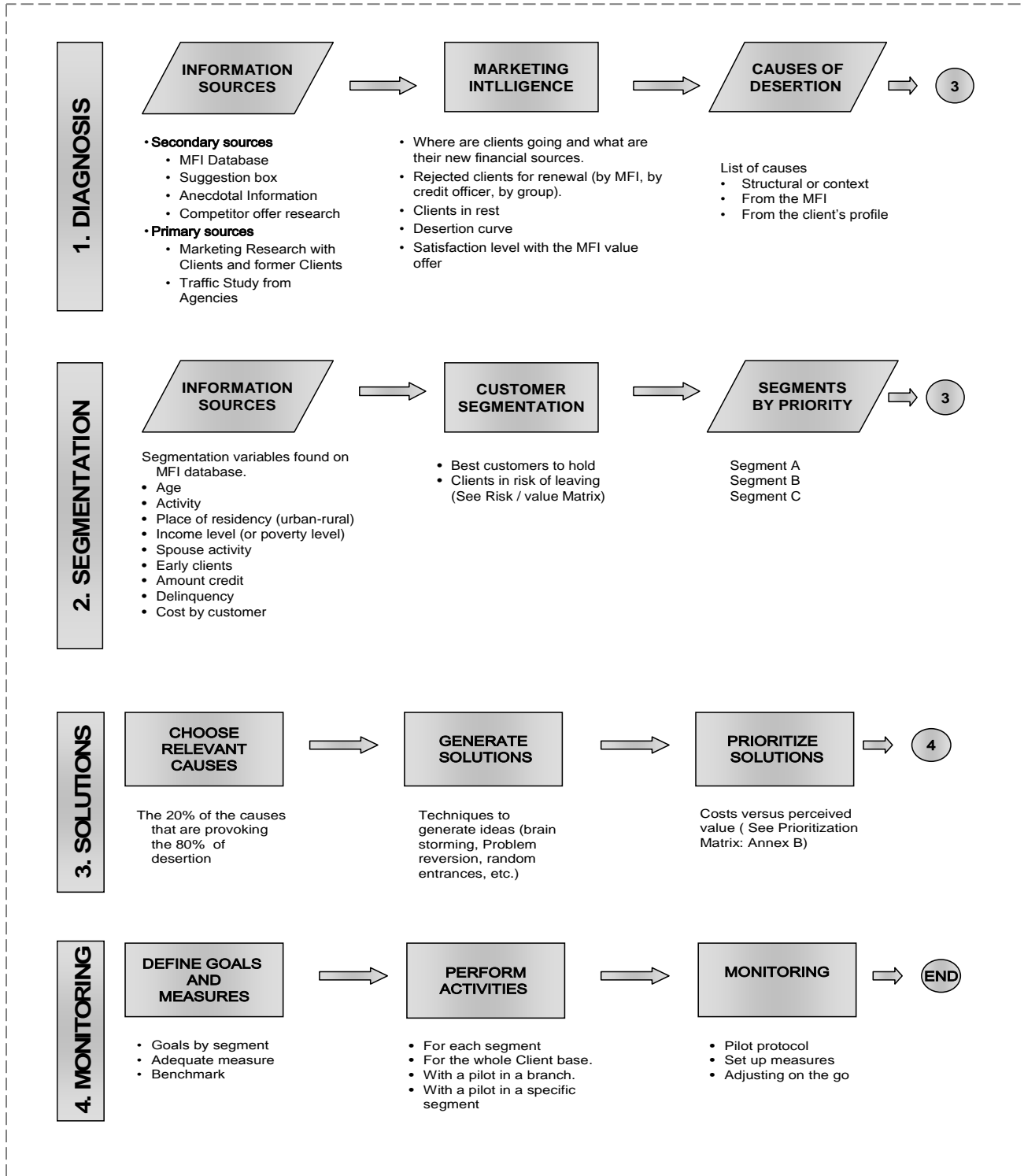
Monitoring only desertion and retention index is not enough to improve the retention rate, comprehensive monitoring of the causes (internal and external) that provoke desertion is needed in order to track an effective change.

Finally, retention depends on the creation of a solid market by helping the customer to grow. The success of the customers is the success of the MFI. In this sense, micro business consulting, networking, training and financial literacy, among others non-financial services must be included on the scope of MFI, if they want a sustainable and solid market in the long term.

ANNEX A

Framework for Retention Improvement

(Long version)



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