Building Customer Loyalty

Craig F. Churchill and Sahra S. Halpern

2001

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<tr>
<td>ATM</td>
<td>Automatic Teller Machine</td>
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<tr>
<td>ASA</td>
<td>Association for Social Advancement</td>
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<tr>
<td>BRAC</td>
<td>Bangladesh Rural Advancement Committee</td>
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<td>BRI</td>
<td>Bank Rakyat Indonesia</td>
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<td>BancoADEMI</td>
<td>Asociación Para el Desarrollo de la Micro-empresa, Inc.</td>
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<td>CERUDEB</td>
<td>Centenary Rural Development Bank</td>
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<td>CD</td>
<td>Certificate of Deposit</td>
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<td>CGAP</td>
<td>Consultative Group to Assist the Poorest</td>
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<td>FINCA</td>
<td>Foundation for International Community Assistance</td>
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<td>Kenya Rural Enterprise Program</td>
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<td>MFI</td>
<td>Microfinance Institution</td>
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<td>MIS</td>
<td>Management Information System</td>
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<td>NGO</td>
<td>Non-government Organization</td>
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<td>PRODEM</td>
<td>Promoción y Desarrollo de la Microempresa</td>
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<td>PRIDE</td>
<td>Promotion of Rural Initiatives and Development Enterprises</td>
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<td>USAID</td>
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Below is a description of the microfinance institutions that contributed to this publication.

- The Alexandria Business Association (ABA) offers small loan sizes with few prerequisites, flexible loan repayment conditions and technical assistance. ABA provides a variety of consulting services to national, regional and international institutions involved in micro, small and medium-sized business development.
- The Association for the Development of Microenterprises, Inc. (ADEMI), was an NGO with a strong record in credit for micro and small enterprises in Latin America. In 1997, ADEMI opened BancoADEMI, a regulated financial institution that finances micro and small enterprises, with more than 98 percent of loan sizes under US$3000.
- Bandesarrollo Microempresas is a subsidiary of Banco del Desarrollo. Bandesarrollo offers a variety of products, including individual and solidarity lending. As of
December 1998, Bandesarrollo Microempresas served more than 15,000 borrowers, approximately 3,000 savers, and had a loan portfolio valued at over $16 million.

- BRAC, a twenty-seven year old rural development program, provides financial services to the landless poor and marginal farmers. Most of its three million customers are women. BRAC is also involved in education and training, health care and family planning, and community organizing.

- Centenary Rural Development Bank (CERUDEB) is a commercial bank that operates thirteen branches throughout Uganda. Approximately 92 percent of CERUDEB's business relates to microfinance. Its mission is to provide appropriate financial services to all Ugandans in a sustainable manner.

- Compartamos provides credit to low-income women in Mexico. Compartamos recently transformed into a regulated financial institution, a status that will grant access to commercial funds to satisfy an increasing demand for services.

- FINCA (Foundation for International Community Assistance) Kyrgyzstan is part of FINCA International, Inc., a nonprofit organization with affiliates in 17 countries. FINCA Kyrgyzstan offers microcredit, small enterprise loans, business training, technical support, and access to alternative credit sources.

- Fundusz Mikro was established by the Polish-American Enterprise Fund, set up in 1990 by a special act of US Congress to stimulate the development of private enterprise in the former communist countries of Eastern Europe. It now has a nationwide network of branches serving microenterprises with individual and group loans.

- Promotion of Rural Initiative and Development Enterprises (PRIDE) Tanzania bases lending on the solidarity group method of self-selected members, and a 3-tier loan guarantee system to ensure repayment. Customers are involved in the administration of the program: they elect leaders to oversee group discipline, loan approval and repayment.

Other institutions that are documented in this guide include the following.

- The Association for Social Advancement (ASA), is an NGO in Bangladesh that specializes in delivering credit to women. It operates over 800 branches.

- BancoSol, located in Bolivia, is the world’s first commercial bank dedicated to the microenterprise sector. It offers a variety of competitive products.

- Caja Los Andes is a private financial fund in Bolivia. Its objective is to promote efficient financial intermediation to the economically underprivileged social sectors.

- Calpiá, a formal financial institution in El Salvador, aims to provide an efficient and sustainable source of financial intermediation to the micro and small business sectors.

- Kafo Jiginew, structured as a credit union, is the largest MFI in Mali.

- K-Rep Bank, a private institution, conducts activities including microfinance services, research, product development, information dissemination, and consulting services.

- Mibanco, a private bank, offers microfinance products including working capital and fixed asset loans, savings, foreign currency exchange, and foreign wire transfers.

- SafeSave, an NGO in Bangladesh, provides financial services to slum dwellers through a daily deposit and loan payment collection service.
Preface

The importance of customer loyalty and customer satisfaction has become increasingly apparent to microfinance practitioners as the microfinance industry has matured during recent years. In the past three years, Centenary Rural Development Bank has grown by nearly 300% in terms of total assets and number of customers served. This dramatic growth has in part resulted from the use of many of the customer service oriented policies presented in this technical guide, Building Customer Loyalty.

Centenary conducted customer service surveys for the past two years in all of its branches and conducted an impact assessment in two of its branches in 1999. Despite the fact that the initial survey indicated that 85 percent of the Bank's customers were satisfied with its services, Centenary launched an initiative to improve and expand satisfaction among its customers. To create customer loyalty through maximum customer satisfaction, Centenary instituted customer service desks, upgraded its software to enable it to serve depositors more quickly, hired additional cashiers and loan officers and introduced new loan products in response to customers' recommendations. Centenary's management has learned that listening to customers results in higher profits, which have actually improved at twice the growth rate of the Bank over the last three years.

As MFIs around the world face increased competition and move towards commercialization, the importance of Building Customer Loyalty is readily apparent. Competition and commercialization are forcing MFIs to become more efficient, and greater customer loyalty leads to lower operating costs and better financial performance for MFIs.

The publication demonstrates how customer loyalty improves profitability, and examines what factors contribute to improved customer loyalty. In doing so, it explores the importance of quality product design and development as well as the significance of good customer service. Additionally, the authors point out how an MFI's structure can enhance customer loyalty, and that MFI staff members must be able to respond quickly to customers' questions, complaints and credit applications if the institution wishes to promote customer loyalty. The guide is full of tools to help MFIs of various sizes and structures promote customer loyalty.

This latest publication in the MicroFinance Network series, geared not only for its members but also for all microfinance practitioners, will allow MFIs to better serve their customers and move toward improved financial results and ultimately, sustainability.

Dirk B. Van Hook
Chief Executive
Centenary Rural Development Bank
December, 2000
Introduction

◊ Does your organization have a problem with customer retention?

◊ Does your microfinance institution (MFI) experience roller coaster growth patterns—periods of expansion followed by consolidation?

◊ Do a lot of first- and second-time borrowers decide that they don’t need your service anymore?

◊ Are you losing a steady stream, or even a trickle, of your longstanding customers to the competition?

◊ Or, if there isn’t another MFI in the neighborhood, do customers grumble about your products and services?

This document is written for anyone working in an MFI, especially middle and senior management, who answers yes to any of the questions above. The following chapters will help you to calculate the effect of customer turnover on productivity, portfolio quality, employee satisfaction, and your own cost structure. This document will provide tools to monitor and improve customer satisfaction, many of which are used by members of the MicroFinance Network. It will also provide guidelines for developing a customer loyalty strategy that can dramatically improve your organization’s bottom line.¹

Background to Loyalty

Most microloans were originally designed with rigid controls to compensate, or in some cases overcompensate, for the fact that the loans were unsecured. While group mechanisms, like solidarity groups and village banks, were the most obvious form of collateral substitute, other elements were also considered important, including frequent repayments, regular meetings, forced savings, small loans for short terms, and zero tolerance for delinquency. To deliver small loans efficiently, MFIs adopted a one-size-fits-all approach to product design. Had microloans been designed from the customers’ perspective, they might look very different.

Some microfinance institutions used their loan products as a screening device. Anyone who had difficulty repaying was weeded out, and not permitted to receive subsequent

¹ “Bottom line” refers to the MFI’s net profit or loss.
loans. This approach created an operational culture in which staff members were encouraged to exclude borrowers over time. This product-driven approach also assumed that the customers who weren’t weeded out would continue to borrow again, again, and again.

The resulting experience with these rigid credit products was largely successful. MFIs served markets with an insatiable demand and customers who were not particularly discriminating. Large volumes of novice borrowers were thrilled that an organization was willing to take a risk and lend to them. And if 25 percent or more of the customers were kicked out because they didn’t meet the strict on-time repayment requirements, there were plenty of prospective borrowers to take their places.

However, the landscape is changing—in some regions it is changing very quickly. In many countries, MFIs are losing their monopolistic control over the market and customers are becoming experienced purchasers of financial services. The microfinance industry is also learning that some of its original assumptions are not true, or are no longer valid. For example, some of the rigid controls designed to exact timely repayment are excessive, which unnecessarily encourages customers to stop borrowing or go elsewhere. And many customers do not want to borrow repeatedly. They don’t necessarily like being in debt. One size does not fit all; in fact, microentrepreneurs are quite heterogeneous.

The realities of increasing competition, a more discerning clientele, and adjusted assumptions suggest the need for a different approach to microfinance. This publication proposes an alternative perspective based on the conviction that enhancing customer loyalty is an extremely important business strategy for a microfinance institution. A loyal customer is one who makes regular purchases, refers others, and sticks with one institution over the long run. Every critical element involved in managing microfinance operations—from product pricing to staff incentives, from marketing to eligibility requirements, from customer screening to the menu of available services—can (and should) be formulated to promote loyalty. While most MFIs recognize the importance of customer retention, few have designed entire business strategies to maximize customer loyalty.

The loyalty approach is founded on the principle that microfinance should be demand-driven. Demand-driven means that MFIs should provide services that are tailored to the requirements of their target market based on information provided by those customers. To that end, this publication suggests ways to listen and learn from your customers, and to incorporate that learning into product design and service delivery.

**About This Publication**

This document lays the foundation for a customer loyalty strategy in a microfinance institution, and then provides tools and suggestions to carry it out. Chapter 1 presents the economics of customer loyalty and demonstrates that the retention of good customers has a profound effect on the income statement of a microfinance institution, by substantially reducing expenses as well as increasing revenue. MFIs that are not able to retain repeat
customers are likely to experience the unwanted circumstances of high delinquency, low productivity, inefficiency, staff turnover, and reduced impact. The second chapter defines customer loyalty and provides strategies for enhancing customer commitment to the MFI. Chapter 3 discusses the organizational development of a customer loyalty strategy, including staff training, incentives and institutional culture.

Chapters 4 through 6 provide tools to measure customer satisfaction and enhance loyalty, as summarized in Figure 1. The best source of information about ways to improve products and service, customer satisfaction, and ultimately loyalty, comes from customers who have left the organization. Chapter 4 provides information about measuring customer defection and learning from lost customers through exit interviews. The next chapter tries to solve the problems of disgruntled customers before they feel compelled to defect by soliciting and resolving complaints. Chapter 6 suggests techniques for measuring customer satisfaction so that the organization has an ongoing means of keeping its fingers on the pulse of its customers, before they become dissatisfied and defect. Chapter 7 contains technical information for carrying out some of the customer satisfaction research, including methods of conducting focus groups, tips on sampling, and survey design.

**Figure 1: Tools to Measure Customer Satisfaction and Enhance Loyalty**

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<td>Mystery Shopping</td>
</tr>
</tbody>
</table>

Overall, the tools and methods suggested in this document make it possible for an MFI to learn from its most valuable resource, its customers. This has several desired effects. First, the institution can use information from its customers to improve the design of its products and services. The improved products and services better meet the requirements of its customers, thereby fostering the institution’s effectiveness in helping customers to overcome poverty. And customer loyalty is enhanced, not only because customers appreciate the improved products and services, but also because the MFI, through the use of customer satisfaction tools, demonstrates that it cares about the customers’ welfare.
The Economics of Customer Loyalty

“The real cost of losing customers is the opportunity cost. What loan level would she have reached? The customer who takes her place in the group only brings in 67 percent of what the original customer would have.”

Jason Meikle, FINCA Kyrgyzstan

Customer loyalty is an important determinant of long-term financial performance. Microfinance institutions in Bangladesh, Bolivia, and other countries are finding that if they do not keep customers satisfied and loyal, competition (from other MFIs, moneylenders, or even commercial banks) will lure their customers away. But competitors are not the only barrier to customer retention; unmet customer demand for both quality products and friendly and efficient service can also contribute to massive customer exits.

This chapter will explain exactly how costly it is to lose customers and the value of customer loyalty. Loyalty is the attachment a customer feels for an organization’s staff, products and services. A loyal customer is someone who:

- Makes regular purchases
- Purchases across product and service lines
- Refers others
- Demonstrates an immunity to the pull of the competition.

Life Cycle Strategy

Most successful microfinance institutions employ a life cycle strategy as a way of providing sustainable or profitable financial services to the self-employed poor. Following the life-cycle strategy, the institution needs to retain customers at least until they generate enough returns to cover the losses that they generated during their initial loan cycles. MFIs typically break even on a customer only after the fourth or fifth loan.

For the first few loans, the costs of acquisition and screening, on top of the regular transaction costs, are usually higher than revenue produced by low loan balances. Only after several

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3 Brand (2000).
loans do the costs come down (through more efficient servicing of repeat customers) and the revenue increases (through larger loans) to reach the point where that loan generates positive net income. And still it will take several more loans before the MFI produces enough revenue to cover the losses of the early loan cycles.\(^4\)

Mibanco in Peru estimates that it does not break even (e.g. cover its costs) until after the fourth loan cycle. If this customer leaves before the break-even point, Mibanco will lose money. If this customer defects to borrow from a competitor, and she uses her exemplary credit history with Mibanco to access better terms from another MFI, then not only did Mibanco lose money on the customer, but it is effectively subsidizing the competition.

**The Significance of Portfolio Diversity**

An alternative way of measuring customer profitability is to consider an institution’s portfolio mixture at one point in time, as shown in Figure 2. If we assume that the cost of providing a loan is basically constant regardless of the loan size, and that the price of the loan (the interest rate) also remains constant, then profitability becomes purely a function of the size of the loan. As a customer’s loan size increases over time, so does the revenue for the MFI.

![Figure 2: Distribution of Costs (Loans) and Revenue (Value) by Loan Size](image)

Loans provided by the organization in Figure 2 (an actual MFI in El Salvador) start becoming profitable somewhere around $1000, where the revenue (value) exceeds the cost (loan). While the simplifying assumptions do not work for institutions that offer

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4 For more information about portfolio diversity and financial viability, please see Appendix B.
5 Gheen et al, 1999
variable pricing, or if the costs of originating a loan vary significantly by loan size, the basic premise still holds that larger loans are subsidizing smaller loans to some degree.

Since MFIs tend to increase a customer’s loan size over time, this evidence suggests that customers need to continue borrowing until their loan sizes surpass a certain threshold, after which they become profitable.\(^6\)

The information in Figure 2 can also be interpreted in a way that can be damaging to an MFI. The alternative interpretation is that MFIs should target larger borrowers in order to subsidize smaller loans. Rather than seeking out customers who need larger loans, MFIs should concentrate their energies on promoting customer loyalty of their core constituency, and on retaining low-risk repeat borrowers, which will naturally create a diversified portfolio over time. Following this system, and taking into account the increased efficiencies of lending to long-term borrowers, loyal customers with low loan balances can be more valuable than the customer with a large loan who never borrows again.

**Word-of-Mouth Marketing**

Word-of-mouth marketing is perhaps more important in microfinance than other service industries. Most MFIs can’t afford lavish marketing budgets, so free referrals are particularly attractive. Loan applicants who have been referred by existing customers often already know the rules of engagement, which can lower the acquisition costs of new customers. For example, MFIs that use a group lending methodology find that many prospective customers arrive on their doorstep with their groups already formed.

<table>
<thead>
<tr>
<th>ABA: Reduced Costs for Repeat Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Alexandria Business Association requires the following procedures for a first-time loan, but not for a repeat loan, making repeat loans less expensive:</td>
</tr>
<tr>
<td>• A visit from the extension officer to observe business operations</td>
</tr>
<tr>
<td>• A visit from the branch manager</td>
</tr>
<tr>
<td>• An audio/video presentation about ABA policies</td>
</tr>
<tr>
<td>Seventy-five percent of ABA’s loans are to repeat customers.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Promoting Customer Referrals: Banco del Desarrollo and Mibanco</th>
</tr>
</thead>
<tbody>
<tr>
<td>According to customer satisfaction surveys, many customers of Bandesarrollo (Chile) were referred to the bank by existing customers. To fully benefit from the lower acquisition cost of these referrals, Bandesarrollo now asks current customers to give them the names of friends who might be interested in microfinance services. Bandesarrollo keeps a database of the names of these referrals, and then sends them marketing materials through the mail and calls them to offer services. About half of the referrals become new customers.</td>
</tr>
<tr>
<td>Mibanco gives customers an incentive to refer new customers. Baskets of non-perishable groceries are on display at each branch, and when an existing customer refers a qualifying loan applicant to Mibanco, the customer receives a basket of groceries.</td>
</tr>
</tbody>
</table>

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\(^6\) See Appendix B for a graphical depiction of the relative value of customers over time.
Additionally, the relationship between the referral and the referrer could provide valuable information to a character lender. If a prospective customer is referred by a good client, who is willing to vouch for his character, that would reflect more favorably on the applicant than if the referring customer was a first-time borrower with chronic delinquency problems. Word-of-mouth marketing therefore reduces costs associated with loan losses and customer screening.

**Improved Efficiency and Productivity**

The retention of repeat customers has a dramatic effect on efficiency and productivity. Based on an analysis of six MFIs in Latin America, Gheen et al estimate that the average cost of attracting one new customer is about one fifth of that customer's total unit loan cost. This finding suggests that, through lower acquisition costs alone, repeat borrowers are 20 percent less expensive to serve than new customers. And of course, lower acquisition costs are not the only benefit generated by repeat customers.

A loyal customer is likely to be a low risk borrower. Since this person has borrowed again and again, the institution has amassed sufficient information to make wise credit decisions. Therefore, if loyal repeat customers represent a greater percentage of the portfolio than new clients, then the MFI is likely to extract a cost savings in the form of lower loan losses.

Besides the acquisition costs, new customers are expensive to serve because they require a significant amount of support. Individual borrowers may need loan officers to complete the applications for them; group borrowers may need to find additional group members and learn the roles and responsibilities of the group. Microfinance institutions can

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7 Gheen et. al. (1999)
significantly reduce the costs of delivering a loan to repeat borrowers in good standing.\textsuperscript{8} To reduce transaction costs, MFIs can shorten loan applications for repeat loans, require fewer business evaluation visits by loan officers, or allow less frequent repayment by customers in good standing, all of which reduce transaction costs. The list of efficiency innovations is long and growing.

Customer loyalty not only improves the MFI’s efficiency ratio, but it also enhances productivity. Since repeat borrowers with good repayment records take significantly less time to manage than new customers, loan officers with loyal customers can manage larger volumes.

\textbf{Loyalty Facilitates Healthy Growth}

If good customers start deserting, your volume will likely remain stagnant because the new recruits will just replace your customers who have left. And since the defectors probably had larger loan balances than their replacements, you might actually see your portfolio decrease. At FINCA Kyrgyzstan, for example, when a customer deserts her replacement only brings in an average of 67 percent of the original borrower’s profit, and that’s only after the completion of the first loan cycle, which is four months long.

Some microfinance institutions experience \textit{roller coaster growth cycles}. These MFIs rapidly expand and then contract to five or ten thousand outstanding loans because they can barely bring in enough customers to replace the ones who are leaving. During the early 1990’s, K-Rep in Kenya faced this common experience. During the years between 1990 and 1995, K-Rep expanded from one branch to 16 branches, and loan officers were given bonus incentives based on their portfolio sizes. Throughout this expansion, loan officers found it easiest to expand their portfolios by offering large loans, and so increased the amount of each subsequent loan, often by a larger amount than the customer—or the group—could handle. When some group members had much larger loans than others, many of the smaller loan customers deserted because they did not want to guarantee such large amounts. At the same time, loan officers neglected follow-up activities with customers who had larger loans, because the staff was too busy drumming up \textit{new} business. Many of the larger loans became delinquent. Consequently, this rapid expansion, in addition to several write-offs of prior loans, ultimately led to a 7.7 percent decrease of the loan portfolio in 1997.\textsuperscript{9}

An MFI that focuses on the loyalty and satisfaction of its current customers (and a reasonable amount of new ones) will have much greater success with customer retention and a low-risk portfolio. Management at K-Rep recognized this in time, and in January 1998, it introduced its “Back to Basics” plan. K-Rep retrained loan officers to adhere to its original philosophy, which included basic principles of microfinance and a

\textsuperscript{8} See Brand (2000) for examples of improving efficiencies in delivering loans to repeat customers. In their research, however, Gheen et al concluded that MFIs make few, if any, changes in the screening and processing phases for repeat customers, and therefore are not taking full advantage of the opportunities to reduce unit loan costs for repeat borrowers.

\textsuperscript{9} Campion and White (1999)
commitment to the microenterprise sector. K-Rep also reduced the maximum initial loan size, reduced the rate of subsequent loan increases, and shortened loan terms, all of which were intended to encourage a steady stream of business from its target market.

The Social Impact of Customer Loyalty

A single $100 loan is not going to make a dramatic difference in most people’s lives. But if that customer’s business grows so that it can make use of increasingly larger loans, the business is likely to spin off impact benefits such as increased income and assets for the household, and perhaps even job opportunities for other low-income persons. Even if the business never grows, regular and sustained access to financial services can stabilize a household’s income and reduce its vulnerability to risks.

In fact, the commitment to customer loyalty embodies the dual mission of microfinance. As customers improve their economic situation, they become more valuable customers. Their savings balances increase, and often their loan sizes do as well. These more successful customers then subsidize the services to customers with the lowest loan balances. Efforts to retain them have the dual effect of enhancing impact and profitability.

While the exact economics of customer loyalty vary by institution, an MFI that attempts to estimate the tangible and the intangible benefits of customer retention will be amazed by the results. Demonstrating the benefits of customer retention, and the associated costs of customer defections will help orient the organization toward an unwavering commitment to promoting customer loyalty. The following chapters provide suggestions on ways to enhance and institutionalize customer loyalty.
2 Enhancing Customer Loyalty

“The time has come for microfinance to address the needs of the customers instead of just the

Carlos Labarthe, Co-Director, Compartamos

To enhance loyalty, the first step is to measure it. With a set of baseline data, an MFI can gauge whether its efforts to improve loyalty are or are not successful. Although loyalty, defined as a feeling or an attachment, may seem like an elusive and subjective characteristic, you can monitor it. The chapter discusses ways of measuring loyalty and then highlights ways of creating value that are designed to enhance customer loyalty.

Measuring Loyalty

Primary Behavior: 3-D Loyalty
To measure loyalty, it is necessary to measure customers’ actual repurchasing behavior. Besides tracking customer retention rates, which is discussed in Chapter 4, MFIs may also want to monitor the three dimensions of customer loyalty: length (longevity), breadth (range of services), and depth (share of purchases).

A longevity measure is the average number of years that a customer has used your services. If an MFI has an average customer life of 2 years, it can monitor customer longevity to determine whether or not it is increasing customer loyalty. In this case, the distribution of longevity is more important than the average number of years that all customers have accessed services. If a mature MFI is able to grow while keeping the percentage of new customers below 20 to 25 percent, then it has promoted loyalty successfully.

For MFIs that offer a variety of voluntary financial services, another measure of customer loyalty is the breadth of their relationship. A customer who has two different savings accounts, a housing loan and a business loan, and a life insurance policy—and her husband, mother and daughter all have savings accounts—is a much more loyal customer than someone who just has an outstanding loan. Some institutions add products with the specific intent of enticing customers to increase their breadth of services. After a survey indicated customer interest, Caja Los Andes made plans to cross-sell housing loans to
existing customers, thus enhancing the breadth of the relationship. To measure the breadth of relationship, MFIs need to have an information system that is organized around the customer, as well as the product, and if possible provides the opportunity to establish family linkages. Not only is the family linkage information useful to measure loyalty, but it also helps loan officers to keep an eye on household over-indebtedness.

And remember, if one member of this family becomes dissatisfied and decides to defect, you might have a big loss when the others decide to follow.

**The ultimate measure of loyalty is the customer’s share of purchases.**

Exclusivity is an important indicator of loyalty and measures the depth of a customer’s relationship with your institution. In fact, the ultimate measure of loyalty is the customer’s share of purchases (the degree to which a customer uses your institution for all her financial services needs). Some MFIs have created regulated financial institutions specifically to provide customers with “one-stop shopping.” Mibanco (formerly Acción Comunitaria del Perú), for example, transformed from an NGO into a bank because a bank could offer the most products and services to its customers, including various loan types and short-term certificates of deposit.

To measure depth (i.e. share of purchases), there are various points to consider. With deposits, for example, what percentage of a customer’s savings or assets is held by your organization? For loans, does the customer have outstanding debts with other lenders?

Besides indicating the degree of loyalty, these details are also important for two other reasons. First, if a customer does have outstanding loans from other sources, you need that information to gauge whether he has the capacity to repay. Unfortunately, customers have a disincentive to provide you with accurate information, since it might adversely affect your loan decision either by reducing the size or rejecting the application outright. MFIs that operate in environments served by effective credit bureaus (such as Bolivia, Chile, El Salvador) are more likely to extract truthful responses in this regard.

Second, information about the customer’s use of savings and loans from other sources provides priceless information for new product development. To meet bonus requirements, loan officers sometimes overlook indebtedness requirements and disburse loans to unqualified customers, thus enhancing the breadth of the relationship. To measure the breadth of relationship, MFIs need to have an information system that is organized around the customer, as well as the product, and if possible provides the opportunity to establish family linkages. Not only is the family linkage information useful to measure loyalty, but it also helps loan officers to keep an eye on household over-indebtedness. And remember, if one member of this family becomes dissatisfied and decides to defect, you might have a big loss when the others decide to follow.

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**Loyalty and Debt**

It is unreasonable to assume that all customers will want to borrow all the time. Credit-only programs have natural desertion rates that vary by region. Some customers will no longer need to borrow; others will only borrow when they absolutely have to. It is difficult to be a staunch advocate of customer retention for organizations that only provide loans, because most people don’t like being in debt perpetually.

Microcredit programs need to find a balance between maximizing customer loyalty and aggressively thrusting loans on people who do not need or want them. One way to make sure that microlenders aren’t too vigilant in their pursuit of loyalty is by developing a realistic estimation of their natural retention rate. If it is 60 or 70 percent, then that can be used to establish staff benchmarks for retention, rather than advocating for a zero desertion rate.
applicants. This behavior needs to be carefully monitored and loan officers should be advised against this practice, as it will likely hurt their loan portfolio performance.

**Secondary Behavior**

Referrals, endorsements, and spreading the word are examples of secondary behavior that indicate customer loyalty. Although it is difficult to quantify the rumor mill, there are two ways of measuring this secondary behavior. The first is to monitor the number of referrals made by existing customers and how recent they are. Customers who regularly refer other customers could be categorized as highly loyal advocates. Loyal advocates who stop making referrals may have had a bad experience, or for some reason are less enthusiastic than they once were. By tracking referral sources, you can identify waning enthusiasm and try to rectify the situation.

While an active list of referrals is a strong indicator of a customer’s loyalty, the opposite is not necessarily true; not all loyal customers are outgoing and know lots of other people who are potential customers. Another way of measuring the secondary behavior is to use customer surveys to inquire whether they would recommend your organization to their friends and neighbors. The answer to this question is a good loyalty indicator, and the simple task of asking the question may stimulate another round of referrals.

Intent to repurchase is an additional sign of loyalty. During the loan cycle, the MFI can systematically ask customers whether they plan to borrow again. Their answers are indicators of future behavior, rather than guarantees, but this information provides useful insights. Intent to repurchase is a strong indicator of satisfaction, and satisfaction is a strong predictor of loyalty. This relationship is discussed in more detail in Chapter 6.

**What Makes a Customer Loyal?**

Repeat patronage does not necessarily demonstrate customer loyalty. MFIs that operate in monopoly-like conditions are particularly vulnerable to this “inertia loyalty,” especially if they are not working hard to maximize satisfaction. MFIs that do not strive for excellence in customer satisfaction are susceptible to customers jumping ship when another institution comes along to offer better services.

An MFI cannot expect blind allegiance from its customers. But if the institution is loyal to its customers, if it is committed to providing them with a service that they value, and it continues to refine and improve that service as its customers’ needs change, then customers are likely to repay the favor in the form of loyalty.

But what exactly is **customer value**? Whether they do it consciously or not, customers consider a complex set of factors when they choose between competing organizations. As shown in Figure 3, total customer value is the aggregate of four types of values: product, services, personnel and image. To deliver value, an MFI needs to consider all four, and needs to determine how its customers perceive their relative significance.
Customers consider a complex set of factors when choosing financial institutions, and these factors are weighed and balanced to produce a net customer value.

Part of maintaining this balance involves managing customer expectations. If customers overwhelmingly expect your MFI to provide quick turnaround for services (services value), and your institution begins to fall short on timeliness, customers will react more strongly than if they had low expectations for turnaround. Staff have an important role in creating realistic expectations for customers. If employees don’t know the terms of products inside and out, they may create false expectations. SafeSave minimizes false expectations by fully and carefully explaining terms to customers in simple language. SafeSave also supplies customers with a written copy of its terms and conditions. By keeping customers fully aware of their responsibilities and options, you can help them to assess the value of your institution.
Fundusz Mikro, which offers group loans, screens potential customers to decrease false expectations. During a meeting with potential customers, branch managers explain the risk of borrowing with a group, and ask the potential customers what they would do if a group member disappears with the borrowed money. Fundusz Mikro wants customers to understand the real risks and responsibilities inherent in group guarantees.

**Enhancing Loyalty**

An institution can enhance customer loyalty by creating customer value through product design, customer service, building relationships, and branding. But efforts to create customer value, and thus enhance loyalty, need to be viewed through the lens of reality. An MFI could maximize product value by not charging interest, and it could improve service value if it were open 24-hours a day; perhaps doubling salaries would result in better personnel value—but it probably would not stay in business very long.

Managing a microfinance institution involves finding the perfect balance between control, efficiency, and customer satisfaction. While examples in this guide emphasize satisfaction, historically microfinance has placed greater emphasis on efficiency and control. In the interest of efficiency, many MFIs offer one basic product that allows them to streamline and simplify their operations. To achieve control, particularly over credit risk in the absence of collateral, MFIs have expected customers to jump through hoops, such as attending weekly meetings and handing over forced savings. In the interest of balancing control, efficiency, and satisfaction, a customer loyalty strategy requires microfinance managers to step back and question their assumptions. Do staggered disbursements have a sufficient impact on portfolio quality to justify the administrative hassle for both the group and the MFI? How many weeks of pre-loan meetings are really necessary to gauge an applicant’s willingness to repay? If a first-time borrower can repay a loan of $50, does it really ensure future success?

Certainly, the answers to these questions will vary depending on the local circumstances, but the point is to question assumptions, and in doing so, analyze each aspect of products and services to achieve a balance between control, efficiency, and customer satisfaction. Customer loyalty allows MFIs to unite these components, because with higher affinity repeat borrowers, MFIs can lower their controls, streamline delivery systems, and tailor services to customers’ needs.
Product Design and Development

To improve product value, the first step is to ensure that your existing products meet your customers’ needs. Many features of microcredit products are poorly suited to the customers’ requirements. The tools described in subsequent chapters can be used to understand your customers’ financial service needs and use that information to improve your existing products and develop new ones.

Improving product value is not a one-time exercise. A commitment to customer loyalty means creating lifelong relationships by providing products and services that will develop as your customers’ needs evolve. Today’s microentrepreneur may need a retirement savings account for the future; her children may need education savings plans. If her business grows, it may need payroll services or she may want to offer employee benefits. If you can anticipate these upcoming needs through customer surveys, focus groups, and other information-gathering tools, you will be well positioned to offer new products to your customers before the competition can. BancoADEMI did just this: by anticipating customers’ future needs, the bank chose to establish a window for small-scale business products instead of allowing its “graduating” customers to move on to the competition.

If a microfinance institution does not use its knowledge about customers to develop the products or services that they need next, it is leaving the door open for another institution to lure them away. The competitive microfinance market in Bolivia provides a case in point. BancoSol, which exclusively offered solidarity group loans for many years, was slow in developing an individual loan product for customers who were outgrowing their groups. When Caja Los Andes entered the market in full force, providing only individual loans, it easily enticed BancoSol’s best customers because it offered what they wanted. BancoSol had unwittingly subsidized the competition since it had helped these customers

Customer Preferences Shape Product Design at FINCA Kyrgyzstan

Through a combination of research techniques, including focus groups, surveys, and management visits to customer groups, FINCA Kyrgyzstan learned about changes customers would like to see added to its loan products. In response to their preferences, FINCA made the following alterations:

New Products
- Small Enterprise Loan (SEL) customers wanted more flexible loan terms. FINCA is now working on a new revolving credit line option for mature SEL groups.
- Customers indicated a preference for individual loans, so FINCA is developing a new collateralized loan product for Village Bank graduates.

Product Modifications
- Groups were unhappy making weekly payments, so FINCA is now allowing a semi-weekly option.
- In the past, there was a 2week delay between loans, which frustrated customers; FINCA is working on cutting that time in half.
“We have seen people with excellent payment histories begin to fall delinquent. When we ask why, the answer is that our services were very important in the beginning, and that their businesses are growing, but after three years of working with us they need other kinds of services (often individual loans with higher amounts). So, the motivation to repay is not the same as the beginning – the priority to repay is falling down from the first place to almost last. If we do not grow with our customers, giving them the services and products they will need in the future, they will fall delinquent and even leave the institution.”

- Carlos Labarthe, Compartamos

establish a credit history, which they then used to borrow from Los Andes.

Although it is tempting to use new products to garner new markets, it almost always makes more sense to offer new or improved products to existing customer segments. You already have a good understanding of that market, and it will be easier for you to build sales volumes with customers who already know you. New products for existing customers also enable you to increase the breadth of your relationship with them, which further strengthens the loyalty bond.

PRIDE Tanzania is working on a new product for customers who are interested in saving. This demand was made obvious when many customers dropped out to access their compulsory savings, and then re-joined shortly after for another loan. The new product will allow customers to withdraw a certain amount from their mandatory savings, and if they choose, they will be able to open a voluntary savings account (once PRIDE surpasses some legislative hurdles).

For credit-only programs, one useful way to enhance customer loyalty is by developing voluntary savings products, assuming the environment and institutional capacity permit. Microcredit alone does not provide the institution with a sufficient array of services to establish lifelong relationships. Customers will not want to be in debt forever, and at some point they will seek out opportunities to build their assets. While in some regulatory environments there are significant obstacles to mobilizing deposits, if your organization recognizes the potential loyalty benefits of offering voluntary savings, then you may find a way to make it possible. This might mean creating a regulated financial institution, a course pursued by many MicroFinance Network members, but it could also involve developing a joint product with a banking institution, which ABA has done with great success. A thorough cost-benefit analysis of the proposed product is a necessary step prior to undertaking this or any new product development.

Another way to build lifelong relationships is to offer customers other business services. Banco del Desarrollo sends out flyers to potential customers to advertise its services. The flyer says, “It doesn’t matter if you don’t want to take a loan right now; you can still count on Banco del Desarrollo. We also offer business development courses and technical assistance that will help you improve your business. Staff at the bank can tell you about our programs.” BRAC also offers business services. For poultry farmers, which comprises a large segment of BRAC’s borrowers, it developed a model for poultry sector development. The Poultry Programme

A commitment to customer loyalty means providing products and services that will evolve as your customers’ needs evolve.
includes assistance for breed development, feed supply, health care, supply of inputs, vaccination, and technical support. BRAC uses market segmentation to provide services to customers in other sectors as well, including livestock, agriculture, environmentally responsible forestry, and fishery.

**Customer Service**

Microfinance institutions often recognize service value, but they don’t always have an enthusiastic commitment to improving customer service. An MFI that is committed to providing quality customer service does the following:

- Regularly checks to ensure the customer is satisfied with products and services
- Seeks out customer complaints and relishes the opportunity to resolve them
- Actively solicits customer suggestions for improvements
- Works to discover new ways of meeting customers’ evolving needs
- Strives to exceed customers’ expectations

Customer service begins at the top. Executive management sets the tone for how staff should treat the customer by how the company treats its staff. It needs to ensure that the head office provides its branches (its internal customers) with quality service so they can in turn provide their customers (external customers) with the best possible service. Senior management also needs to step out of the office on a regular basis and talk to customers, both internal and external. Pancho Otero, the founding managing director at BancoSol, regularly spent days in the branches working as a teller to keep in touch with customers’ demands and to ensure that the services provided by the main office were meeting the needs of the branches.¹⁰

Word-of-mouth marketing needs to be cultivated by creating experiences that your customers will want to tell others about.

The first chapter made the case for customer referrals, but word-of-mouth marketing does not just happen by itself. Customers feel compelled to recommend your services to someone else because they have received something valuable from you. By focusing your staff’s attention on this issue, you can encourage them to cultivate word-of-mouth marketing by creating positive experiences that their customers will want to tell people about. And if that story is so compelling, it may become grist for the rumor mill and reach ears several generations away.

On the flip side, bad news travels a lot faster than good news. One person’s negative experience can quickly be translated into “I’ve heard lots of people are being treated unfairly at MicroBank.” And dissatisfied customers are more likely to tell people about their unpleasant experience than a satisfied customer.

¹⁰ Churchill (1997)
Ninety percent of dissatisfied customers whose problems are not solved will never do business with the institution again; but when customer complaints are received, responded to, and fixed, there is a 90 percent chance that the formerly unhappy customer will return. Complaints also provide a valuable source of customer satisfaction information. A database of customer service complaints can help categorize issues to focus on the underlying reasons for the complaints. Chapter 5 addresses this issue in detail.

It is not sufficient, however, to focus on complaints, because perhaps as few as one in fifty dissatisfied customers actually voices concerns. MFIs need to use tools that make it possible to regularly gauge the tenor of customer sentiment. They also should make it easy for customers to communicate with them. For example, branch managers at ABA meet new customers as an important internal control function, which also creates an opportunity to solicit their opinions, make them feel comfortable about expressing themselves, and let them know that ABA has an open door policy.

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**Back-office Roles in Providing Customer Service**

Although microfinance literature concentrates on the transactions between loan officers and customers, another critical set of customer service relationships exists: between front line staff and the back office. Loan officers, tellers, and other branch staff are the public face of an institution, but they cannot function without the critical inputs provided by the finance, administration, human resources, MIS, and other head office departments. Without timely disbursements and reports, without petty cash and travel reimbursements, if receipts aren’t processed or training provided, field staff cannot provide exceptional customer service.

Unfortunately, field staff do not always receive exceptional service from the head office. Since they operate one or two steps removed from the customers, head office staff need to have the institution’s mission brought to life. Regular opportunities to shadow loan officers or meet with customers at the branches allow back office staff to interact with microentrepreneurs and appreciate how much the customers value the MFI’s services. This reminder of the realities of frontline staff can motivate back office workers to make life easier for their colleagues in the field, who in turn will provide better service to their customers.

Management at Compartamos has seized onto this philosophy. Each year at Compartamos, the head office staff spend one day with a loan officer, visiting customers. This day enables them to more fully understand the meaning of their work, which increases their job satisfaction and in the end benefits the customers.

Specialized customer service training for head office staff can also help them to connect with frontline employees. Devise workshop activities for these employees to convey the following messages:

- How can you serve the branches better?
- Avoid the “Blame Game”: Assume you are part of the problem and fix it.
- Solicit complaints and relish the opportunity to solve them.
- Be responsive, not defensive.
- Generate empathy: Put yourself in the shoes of the field staff.

At the end of the day, every employee needs to remember where his or her paycheck comes from: the customer.


Building Relationships

In microfinance, the personal relationship between customers and front-line staff is more important than in most service industries, making **personnel value** of utmost importance. Loan officers who create close relationships with their customers develop a sixth sense in evaluating an applicant’s character and repayment capacity. At BancoADEMI, interviews with both customers and loan officers reveal that the strong relationship between the two is an essential element of the bank’s history of excellent repayment performance.

Some MFIs may find that educated loan officers look down on illiterate or otherwise underprivileged customers. Communicate to them that this behavior is counterproductive and unacceptable. A constructive relationship encourages customers to be forthright about pending delinquency problems, which enables them to be solved more easily and with less stress on everyone. And most importantly, that personal relationship breeds customer loyalty.

Desertion can become a problem if MFIs fail to communicate with their customers after the loan is booked. Usually, this after-loan care is approached as a delinquency prevention technique, but it is perhaps more important as a means for encouraging repeat business. When frontline employees create relationships with customers, rather than just booking loans, they place an appropriate emphasis on post-disbursement activities. To generate personnel value, loan officers still conduct customer visits, but the purpose of the visit is not to verify how the customer used the loan or to make sure that he didn’t skip town. Rather, it is to see how business is doing, how the family is doing, and to see if the customer is faring well with the services provided. To make such visits cost-effective and to minimize their impact on loan officer productivity, the loan officer stops by customers’ homes on the way to or from regularly-scheduled loan disbursement or collection activities. While these visits are informal, loan officers must maintain a sense of professionalism during the visits so as not to imply relaxed attitudes toward timely repayment.

Fundusz Mikro, in Poland, found that staff resisted building relationships with customers because they didn’t fully understand the expectations of microfinance loan officers. Since Poland had operated in a closed economy for so many decades, loan officers could only identify their jobs with those of bankers, who were not focused on building long-term relationships with customers. After

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**SafeSave’s Convenience**  
**Equals Customer Satisfaction**

Customers at SafeSave, Bangladesh, appreciate the personalized and committed service that this MFI provides. Customer satisfaction research indicates that SafeSave’s efforts to provide both convenient and flexible services are the most important sources of satisfaction. Some of SafeSave’s policies that customers value the most include:

- To allow customers to save the amount they choose to at the time they choose.
- To allow customers to withdraw when they choose.
- To go to the customer every day to collect savings, which makes it easy to save.
- To allow customers to save very small amounts.
- To provide service without weekly meeting requirements.
- To provide individualized saving and lending services.
determining that loan officers’ inability to establish such relationships was increasing customer exits, Fundusz Mikro began to interview and test prospective employees for personality traits that are conducive to positive relationship-building. Loan officer candidates now have to sign a contract that recognizes relationship-building as an integral part of their employment by stating that one of their most important tasks is to forge strong ties with customers.

The relationship between the customer and the organization can be reinforced—and the customers’ loyalty strengthened—through a variety of customer involvement activities. Some MFIs have customer advisory boards, which provide a channel for valuable customer feedback, but also advance the commitment that the customer and the MFI have to each other. Depending on their availability, advisory board members can perform a range of functions that will deepen the relationship, such as serving on a credit committee or interviewing prospective loan officers to make sure they have the right approach toward customer service.

Branding

Of the four, perhaps the most overlooked customer value is image. This prioritization is understandable given that image value probably carries the least weight with microfinance customers. Yet precisely because it is generally underutilized, MFIs, particularly those in competitive markets, may be able to generate the greatest additional customer value through an effective branding strategy.

A brand is an image, cultivated through marketing strategies, that identifies the products or services of one company and differentiates them from those of its competitors. A brand is more than just a name or an easily recognizable logo. It conveys a complex level of meaning about the company, its products, and its customers. Strong brands generate loyalty because customers like being associated with the image that the company or its products represents.

For example, through talking to customers, BancoSol has discovered that customers do not want a “bank for the poor,” since they pay their debts, pay their bills, and have businesses. BancoSol customers do not want to be reminded of their economic status, they simply want a bank. BancoSol’s marketing department has tweaked the bank’s image through marketing materials and advertisements—so that it reflects this sentiment. New marketing materials boast, “We really explain all of its products. A piece of marketing material for individual loans contains a picture of a middle-class man with a caption proclaiming that services are “simple and rapid.” Another marketing piece asserts that BancoSol will keep deposits secure with state-of-the-art technology.

A brand differentiates the products and services of a company from those of its competitors.
BancoADEMI also takes steps to make its image known. Radio advertisements feature customer testimonials, followed by the slogan, “BancoADEMI is the bank that always gives you a hand.” The principle is that BancoADEMI works hand-in-hand with customers who are experienced in their field and are capable of using credit wisely and paying real rates of interest. Like BancoSol, BancoADEMI treats its customers as partners.

**Loyalty Incentives**

Besides a value-creation strategy, some businesses rely on carrots, and in some cases sticks, to enhance customer loyalty. Companies that realize the importance of repeat customers have developed incentive programs to enhance customer retention. The following are some examples of how this works, or could work, in microfinance:

- **VIPs.** Some microfinance institutions, such as Calpiá (see box), classify their best customers as Very Important Persons (VIPs), which entitles them to preferred services that include a lower interest rate, faster loan processing, and access to additional financial products. This approach rewards timely repayment (rather than punishing delinquency), lowers administrative expenses, and provides customers with a tangible reward for their repeat patronage. VIPs at BancoADEMI are issued MasterCards, which they can use to withdraw cash at branches and ATMs, or pay electricity, telephone, and other bills. Income requirements and an excellent repayment record qualify customers for this service, which may in the future be used to automate the disbursement and repayment process, which will undoubtedly further boost customer satisfaction. These same customers are also eligible for home improvement loans.

- **Milestone Awards.** Awards can be given to customers who meet certain milestones. For example, they may be classified as “golden customers” once they have been with you for five years, and this could entitle them to receive one loan at half price. Or perhaps once they have successfully repaid ten loans without delinquency, they can receive their 11th loan at a discounted rate. These types of programs not only reward repeat patronage, but they also create disincentives for desertion since a customer on his ninth loan will want to make sure he sticks around for at least one more cycle so he can get his reward.

- **Bulk Buying Discounts.** Some MFIs have negotiated discounts for their

<table>
<thead>
<tr>
<th>The VIP Treatment at ABA and CERUDEB</th>
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<tbody>
<tr>
<td>ABA allows its VIP customers to postpone payment of a loan installment for one month without a negative impact on their repayment status. The customer is eligible to receive this “shift” if he requests it before the due date of the installment, has received three successive loans from ABA, and has a clean track record. ABA doesn’t lose profits, because it requires one month’s interest at the time of the shift, and customers avoid sullying a clean track record in a time of temporary hardship.</td>
</tr>
<tr>
<td>Centenary Rural Development Bank (CERUDEB) rewards its best customers with reduced fees. When a borrower pays three loans on time, her effective interest rate is lowered from 48 percent to 30 percent, and she maintains that rate as long as she continues paying promptly.</td>
</tr>
</tbody>
</table>
customers from wholesalers. To make this a loyalty incentive, the institution needs to issue special identification cards that expire when the loan term ends; if the customer renews the loan, then the card can be updated.

- **Newsletter or Magazine.** Where MFIs serve mostly literate entrepreneurs, they may enjoy receiving a free subscription to a magazine or newsletter with tips on running your own business. ABA sends a free newsletter out to its best customers.

- **Training Courses.** Some MFIs, including ABA, BRAC, and BancoADEMI, offer training courses or mentoring as a part of their services. Assuming that the MFI charges for these services, it can offer discounts for VIP members.

The experience with loyalty incentives in other industries suggests that the first company to introduce such a program will benefit the most, especially if the competition is slow to respond. Once the whole industry has similar reward programs, then the companies that offer the most distinct programs, that offer relevant benefits to their customers, and that are operated most efficiently, can succeed in using loyalty incentives to forge mutually rewarding relationships with their customers.

It is important to note that repeat customers can be more demanding and discerning than first time customers. Their expectations increase over time. As a result, these incentive programs have to keep evolving as well. In general, incentive programs can create administrative headaches and become more trouble than they are worth. They need to be approached as a long-term strategy because it can become a public relations nightmare if the organization decides to close down its rewards program. Perhaps the most important advice in developing loyalty incentives is to keep it simple and relevant, and to make sure

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**Preferred Services at Calpiá**

**Customer rating system** that enables its best customers to access preferred services. The rating system combines quantitative and qualitative indicators on a scale of 1 to 5. The quantitative measure is based on the average number of days late per repayment; customers who average less than 3 days receive an excellent rating (1) and those between three and five receive a good rating (2). Using the same scale, the loan officer also gives the customer a rating based on his or her cooperativeness. So that if a customer missed a payment because of a good reason like a death in the family, the loan officer rating can make sure that she isn’t unduly penalized.

Customers who receive a 1 or 2 rating for several standard loans become eligible to access a second-tier of preferred loan products, including seasonal loans and automatic credit. **Seasonal loans** are short-term working capital loans intended for periods of peak demand. They can be accessed concurrently with other microenterprise loans for customers whose previous loan was repaid with a 1 rating and who have never exceeded a 2 on any loan. Calpiá’s **automatic credit** is similar to a line of credit, except that each time customers draw down on their credit limit, they sign a separate loan contract. To access automatic credit, the customer must have repaid three standard loans with a 1 rating or maintained a 1 rating for 12 months. Once they are eligible for automatic credit, customers receive a “Preferred Customer” identification card and the loan officer conducts a detailed analysis of the business to set the credit limit. The interest rate on the automatic credit is also lower than on the standard loan product to reward those customers and encourage their loyalty.

From Churchill (1999)
that the interests of all parties are aligned.

These measures of enhancing retention are primarily applicable to larger MFIs, particularly those that operate in competitive markets. A smaller, newer MFI is more concerned about attracting new customers than retaining old ones. And all MFIs should make sure that the costs of customer-centered initiatives do not outweigh the benefits. However, the earlier an institution embraces a commitment to both quality customer service and understanding how to provide what the customer wants (rather than trying to convince customers that they want what the institution offers), the more that institution will thrive.
Creating Loyalty through Organizational Development

“Profits and growth are stimulated primarily by customer loyalty. Loyalty is the direct result of customer satisfaction. Satisfaction is largely influenced by the value of services provided to customers. Value is created by satisfied, loyal, and productive employees. Employee satisfaction, in turn, results primarily from high quality support services and policies that enable employees to deliver results to customers.”

Heskett et al (1994)

In the Customer-Loyalty Chain, described above and depicted graphically on the following page (see Figure 4), “satisfied, loyal, and productive employees” are a critical link in the reinforcing cycle that produces customer loyalty and profits. It is not possible to design a customer loyalty strategy without considering ways of hiring, training, and maintaining this cadre of satisfied, loyal and productive staff members. This chapter deals with the organizational development aspects of customer loyalty.

Frontline employees stand at the intersection between the customer and the company. They can make or break a microfinance institution. No matter how good the loan and savings products are, if they are not delivered in a way that generates customer value, the organization will struggle.

To develop a customer loyalty strategy, an MFI needs to maintain satisfied and productive employees who deliver quality services. This is accomplished through the following:

- Institutional culture of customer service
- Decentralized structure that empowers frontline staff members
- Screening methods to hire the right staff
- Staff training on delivering value
- Aligning staff incentives with a customer loyalty strategy
Figure 4: The Links in the Customer-Loyalty Chain

Adapted from Heskett et al (1994)
Loyalty is reciprocal. The more loyalty you give, to your customers and to your employees, the more loyalty they will give you. When loyalty is threatened, it probably won’t disappear all at once, but it can gradually erode if the organization does not have a continuous commitment to achieving it. The most effective way of institutionalizing this commitment is by integrating it into the organization’s structure, culture, and human resource development.

**Organizational Structure**

There is a direct relationship between the structure of an organization and its ability to be responsive to customers, its capacity to provide quality service, and its potential to enhance customer loyalty. In hierarchical organizational structures, where approval for everything is centralized in the head office, staff members cannot respond quickly to questions or complaints because they have to seek higher authority.

By contrast, in a flatter or more horizontal organization, where there aren’t layers of middle managers, frontline employees have to assume greater responsibility. If those employees are capable and well trained (which can be a big IF in certain labor markets), then they can respond quickly to their customers. A flat organization is also more likely to involve frontline employees in developing new products and setting polices and procedures. Field staff often have excellent suggestions because they are closer to the source of the problem. To promote customer loyalty, the organizational structure should empower field staff to respond to customers needs.

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**Desertion and Management Problems**

Customer desertion is not caused solely by poor service and inappropriate products. Desertion can also be generated, or accelerated, when an institution experiences management problems. Fraud can cause desertion if customers (especially savers) lose trust in the organization. Liquidity problems that cause delays in fulfilling loan requests can also stimulate a major exodus.

When people become customers of a microfinance institution, the MFI and the customer enter into an agreement: the customer will repay her loan and, in return, the MFI will provide access to timely and appropriate services on an ongoing basis. If MFIs are sincere about customer loyalty, they will take their commitment to their customers as seriously as they expect their customers to take their repayment responsibilities.

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**Common methods for managing credit risk may be in conflict with a customer loyalty strategy.**

Where is loan approval authority located? It is a good credit risk and internal control policy to limit the loan sizes that can be approved by branch staff. If loans are above that threshold, then they are approved by a credit committee; and if they are larger still, then they are approved at the head office.

This arrangement, however, runs counter to a customer loyalty strategy. Presumably, many larger loans are going to long-standing and valuable customers. These are the very customers that you want to please the most, and yet they aren’t going to be too happy if they have to wait two or three weeks for their file to be reviewed at the head office.
Instead, an MFI needs to manage credit risk and establish internal controls without annoying its best customers. Perhaps a proactive loan officer can alert relevant authorities that a large loan request is in the works so that they can plan accordingly. Or the credit committee can schedule a special meeting to review the file. In sum, the structure of the organization (and the allocation of authority) needs to reinforce, not undermine, a customer loyalty strategy.

**Organizational Culture**

The MFI’s organizational culture shapes how employees behave within the context of its policies and procedures. Some policies are set in stone; others can be bent in special circumstances to improve customer service. MFIs need to be careful that employees don’t hide behind the policy at the expense of customer service: “I am sorry, ma’am, there is nothing I can do about it. That is our company policy.” If employees understand the purpose of the policy, and the organization’s culture encourages them to solve people’s problems, then frontline staff members can find mutually beneficial solutions that aren’t in the regulations manual. By creating an environment in which employees see themselves as “problem-solvers,” they can think of creative ways of solving their customers’ problems that may run counter to the letter of the law as long as they are consistent with its spirit.

Most MFIs have very strict repayment schedules. Customers need to pay on or before the repayment date or they will be considered delinquent and subject to penalties. So what should a loan officer do if a customer, because of her business’ cash flow, will always be late? The loan officer should be empowered to help the customer find a solution to this problem, and in extreme cases she should be able to reschedule the repayment date to accommodate the customer. If there is a pattern of strict amortization schedules not matching the cash flow patterns of customers, loan officers should feel comfortable approaching management with the problem, and policies should be changed to balance the needs of the customer with those of the institution.

This flexible, problem-solving approach is an ideal way of improving customer service, but it creates some operational challenges. As soon as an MFI devolves authority to the branch level, and encourages employees to bend policies to meet customers’ needs, its vulnerability to fraud increases exponentially. Therefore, a shift toward empowered frontline employees needs to be balanced with a corresponding increase in internal control vigilance and a heavy emphasis on creating a culture of honesty and trust.

A culture that promotes **teamwork** also has a positive effect on customer loyalty. When employees work well together, they create a pleasant environment to be in. Customer service benefits since a teamwork approach

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“Wholly negative responses to our [survey] questions represent less than 1 percent of the two and a half thousand responses tabulated. That is quite an achievement and Centenary Bank staff should take pride in that fact. The large number of people who bothered to add written comments also bears testimony to the fact that Centenary Bank has a lot of loyal customers. Does that mean that customer service cannot be improved? Of course it can and customers, in the main, want a better service. They want it because they believe that Centenary Bank can give it. It is up to everyone to make it happen.”

- From a report entitled “Levels of Customer Service in Centenary Bank,” carried out by UMU Consultancy Services, Nkozi, Uganda.
means that customers will be attended to no matter whose customers they are. During staff training, continuously emphasize the importance of teamwork to instill the value in employees’ work ethic. To encourage problem-solving and teamwork, some MFIs award “Employee of the Month” prizes to the employee who best lives by these tenets. Place a framed picture of the employee in prominent places in the office (accompanied by an Employee of the Month caption), and give the employee a certificate recognizing the accomplishment.

An organization’s mission statement reflects and reinforces the institution’s culture. But many mission statements, full of lofty ideals and goals, have little bearing on the daily transactions between employees and customers. It shouldn’t be that way. Evaluate your existing mission statement by analyzing it under the microscope of the following questions:

1. Where would your organization be without your customers?
2. Do you think customers care about your mission statement written the way it is?
3. Can anyone in your organization recite the mission statement by heart?
4. Does anyone in your organization think about the mission statement when interacting with a customer?
5. Who was involved in writing the mission statement?12

The mission statement by itself can’t accomplish anything. It needs to be publicized and promoted. It needs to be used to motivate people, not just to do well, but to constantly improve. To achieve and maintain customer loyalty, the organizational culture should encourage employees to do better tomorrow than they did today.

**Human Resource Development**

The delivery of microfinance products is just as important (if not more important) as the products themselves, which heightens the significance of the people who provide these services. This section looks at three aspects of human resource development—hiring, training and rewarding employees—that are critical buttresses of a customer loyalty strategy.

**Hiring for Loyalty**

The longer employees stay with your organization, the more familiar they become with your business, the more they learn, and the more valuable they can be. For all employees who deal directly with customers, the retention of those staff members can have

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12 Adapted from Gitomer (1998)
a powerful effect on customer loyalty. Over time, loan officers and customers build a bond of trust. If that employee leaves, the bond is broken. SafeSave in Bangladesh finds that when it has to let an employee go, some of his or her customers invariably go too. The retention of quality employees, therefore, is an important strategy to achieve customer loyalty. And, as in the case of loyal customers, the best source of new employees is from current employees with a good track record.

An MFI should select the right employees before enticing them to stay. To find the right staff members, some MFIs utilize careful screening techniques that test for appropriate personality traits, aptitude, and a commitment to the target market. These tools may include written tests, individual and group interviews, and role-play exercises. To develop screening tools, it is first necessary to identify the characteristics of a loan officer who is perfectly suited to promote customer loyalty, and then compare applicants to the archetype. One way to discover this archetype is to analyze data on staff turnover to see if there are any patterns in staff members who remain loyal and effective employees. For example, BancoADEMI looks for character, skills (including an undergraduate degree in accounting, business, or economics), and enthusiasm in its loan officers. The features in Figure 5 provide an example of the ideal candidate that an MFI might look for when hiring a loan officer.

**Figure 5: Sample Characteristics of the Archetypical Loan Officer**

<table>
<thead>
<tr>
<th>Character</th>
<th>Outgoing, friendly, team player, sincere, creative</th>
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</thead>
<tbody>
<tr>
<td>Skills</td>
<td>Combination of “soft” and “hard” skills, an ongoing</td>
</tr>
<tr>
<td></td>
<td>commitment to learning</td>
</tr>
<tr>
<td>Enthusiasm</td>
<td>Care and concern for the MFI’s target market, willingness to work in difficult conditions (field worker not an office worker)</td>
</tr>
</tbody>
</table>

Once you have a clear idea of who you are looking for, you can develop ways of testing candidates to see if they compare favorably to the ideal. To screen for personality traits, for example, you might ask two candidates to act out a scenario whereby one is trying to collect a payment from the other. A math test can help determine their aptitude with numbers. Competent, efficient, and caring loan officers play a large role in retaining satisfied customers.

**Training for Loyalty**

Unless you are hiring away employees from your competitors, you are not likely to find too many people who walk in the door with the requisite skills to perform the job. And even if they do have the technical skills, they still need to be infused with your organization’s culture, which should educate them about the importance of customer loyalty.

When training staff, it is essential to highlight and continuously reiterate the value of customer loyalty. In deference to the dual mission of microfinance, balance this commercial argument with the social objectives: the only way loan officers can really help the target market is if they serve the right customers and they provide services to those customers over the long term.
Through training, the MFI communicates that anyone who interacts with customers needs to learn how to go above and beyond the call of duty. Customer satisfaction is the *minimum* acceptable level of achievement, whereas loyalty is a much more powerful, and profitable, accomplishment. To teach staff to go beyond satisfaction and achieve loyalty, consider a training exercise whereby frontline employees identify ways that they can achieve the loyalty-related objectives listed in the left-hand column of Figure 6.

**Figure 6: Achieving Loyalty, A Staff Training Exercise**

<table>
<thead>
<tr>
<th>Objective</th>
<th>Sample Responses from Trainees</th>
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<tbody>
<tr>
<td>Be unusual where the usual is expected</td>
<td>Make visits to the office something that customers look forward to by keeping the atmosphere interesting. Change the posters on the walls every month; highlight a motivational thought for the week and the joke for the day. Anything that we can do to make the customer’s experience memorable increases the chances that they will tell someone else about us, and increases the chances that they will come back again.</td>
</tr>
<tr>
<td>Help your customers to improve their businesses</td>
<td>Each week we could give a different customer (at least those who have achieved the preferred status level) a chance to set up shop in front of our office to ply their wares or demonstrate their trade. Cover an entire wall with corkboard and allow customers to use it for advertising space. Give customers a forum to form trade associations if that will help them to purchase supplies in bulk.</td>
</tr>
<tr>
<td>Give proactive service</td>
<td>Keep track of which loans are coming due, so we can talk to them beforehand about what they might want to do next.</td>
</tr>
<tr>
<td>Get to know your customers</td>
<td>It is hard to remember 300 or 400 people by name, but it can make a big difference if we can. When they walk into our office and we greet them by name, they will feel comfortable. Even better, take it a step further and inquire about their spouse and children as well.</td>
</tr>
<tr>
<td>Give friendly service</td>
<td>Make sure that we have smiles on our faces, and that we are they genuinely interested when we ask “How are you today?” Don’t answer the telephone by saying, “Hello, this is MicroBank;” instead say, “Thank you for calling MicroBank. Our goal is to make you happy. How can I help you today?”</td>
</tr>
<tr>
<td>Give them a useful gift</td>
<td>When we give away knickknacks like calendars or key chains, make sure that they are creative so that customers will be proud (or amused) to show it off and it will attract the attention of others.</td>
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</tbody>
</table>

To ensure that credit officers are creating solid and valuable customer relationships, BancoADEMI provides an initial two week hands-on training period, as well as on-going professional development for at least five days per year. BancoADEMI also holds an annual staff meeting, during which staff share experiences, review previous performance and discuss future goals, all of which enhance camaraderie among staff members. In their sessions, staff learn new techniques and discuss ways to improve their relationships with customers.

One of the most challenging, yet valuable skills is the ability to resolve customer complaints. Efforts to resolve complaints can dramatically enhance customer retention, therefore training for customer loyalty places an important emphasis on improving
resolution techniques. The most effective way of teaching these skills is through role-playing exercises. For example, one trainee plays the role of a customer with problems based on a real scenario, and another trainee acts as the employee who tries to help solve them. Then the audience, consisting of other trainees, critiques the techniques used by the problem solver and offers its own suggestions. For this to be practical, the human resource department needs to maintain a database of problems and complaints based on information sent in from the branches. Since new problems and complaints are continuously arising, it is a good idea to provide an annual refresher course on complaint resolution for all frontline employees (for more details on problem identification and resolution, see Chapter 5).

**Rewarding**

MFIs should view their best employees the same way they view their best customers: once you find the right people, do everything possible to keep them. Since it is expensive to train staff, a high level of staff turnover can be detrimental to the organization. It may be helpful to estimate staff training costs per person to underscore the importance of staff retention.

Rewarding staff is one way to encourage job satisfaction and, ultimately, a long career with your institution. An MFI that wants to retain staff needs to position itself as a premier employer. This involves providing a competitive compensation package, but it is much more than that. This section discusses the financial and non-financial aspects of rewarding staff in order to enhance employee loyalty.

Employees won’t stay unless they have an incentive to do so. All other things being equal, the best people will stay with the company that pays the most. Yet salaries are already the biggest line item in most budgets—can MFIs really pay more? Before answering that question, try to calculate the costs of losing good people, which includes hiring and training replacements, higher loan losses and lower productivity of novice employees, and the negative impact staff turnover has on customer loyalty. While this estimation will rely heavily on educated guesses, it will probably show that MFIs can’t afford not to appropriately compensate (and retain) their best employees.

Compensation packages should encourage both employee and customer retention. A profit-sharing plan can be designed to allow employees to share an increasing percentage of the company’s profits, the longer they stay with the organization. For example, after three years, they can have access to a quarter share, after 5 years a half share, and after 10 years a full share. Although not designed specifically to enhance staff retention, CERUDEB has a profit-sharing plan that gives employees ten percent of the bank’s net profit. The better the bank does, the more employees can earn. Profit sharing at the branch or unit level is a major component of BRI’s staff incentive scheme.
Employee ownership can help to enhance staff retention, but it comes with the risks associated with any equity stake. **Employee stock options** can be designed so that, after a minimum number of years, staff become eligible for an increasing number of shares. K-REP in Kenya has such an ownership scheme in which an employee cooperative owns a 25 percent stake in the bank. This promotes employee loyalty and aligns company and employee incentives. For this scheme to be effective, employees typically purchase shares that the company matches at some pre-determined ratio. If the bank does well, there can be a significant upside to such an investment, but if it does poorly, the employees could see the value of their investment erode so there is a potential to lose money.

**Pension plans** (used by PRODEM and BancoADEMI) are another method of compensation. **Staff incentives** can also be aligned directly with a customer loyalty strategy by rewarding employees for retaining customers, as ABA does. To receive bonus incentives, a loan officer at ABA must have repayment rates greater than 97 percent and he must have six new loans and fifteen repeat loans each month, which emphasizes the importance of customer retention.

Fortunately, all other things don’t have to be equal. MFIs don’t have to necessarily pay the highest wages to have the most loyal employees, although it certainly helps. Other factors that influence an employee’s satisfaction include:

- Benefits such as health insurance and vacation time
- An institutional mission where people feel that they can make a difference
- Workplace design that is comfortable and conducive to productivity
- An institutional culture that is unique so that employees feel like they are part of a special team

### The Conflict between Staff Rotation and a Customer Loyalty Strategy

Some MFIs, including BRI Unit Desa, the world’s largest microfinance institution, insist on rotating staff between branches on a regular basis as an internal control mechanism. This is based on the (correct) assumption that increasing familiarity between staff and customers creates opportunities for duplicity. But do the risks of collusion outweigh the negative impact staff rotation can have on customer loyalty?

When a loan officer moves to a new branch, she takes with her local knowledge that makes customer service special. She knows that Mrs. J likes milk in her tea; she knows that Mr. R always pays on Thursday even though he’s supposed to pay on Wednesday. Customers who become accustomed to these little things will experience a drop in satisfaction when the loan officer is transferred. If the MFI operates in a competitive market, then the loss of personalized customer service may push customers to conclude that it’s time to see what the competition has to offer.

Customer service isn’t the only operational aspect affected by staff rotation. Loan officers and branch managers develop local knowledge that enhances customer screening and delinquency management. Employees amass information that cannot be conveniently documented in customer files, including relationships with community leaders who supply character references and pressure points for extracting repayments. If these employees are transferred to other branches, they have to learn a whole new set of customers and community relationships, as do the people who replace them.
Creating Loyalty through Organizational Development

- Recognition of individual and group accomplishments
- Staff development and job enrichment opportunities

To understand what mixture of these (and other) non-financial rewards is appropriate for your employees, you can use many of the same techniques designed to learn about customer needs. An employee advisory committee is a useful sounding board in the development of new human resource policies. MFIs may also consider conducting employee satisfaction surveys and implementing employee complaint and suggestion systems. The greater voice you can give to your employees in shaping their work environment, the greater chances you’ll have in creating working conditions that promote employee loyalty.

To retain employees, some businesses hold out the carrot of promotion prospects. Employees on the fast track remain with the organization because they see ongoing opportunities to climb the corporate ladder. But this approach isn’t congruent with a flat institutional structure. So how does an MFI keep staff motivated without promoting them away from their customers? An alternative to advancement is job enrichment. Job enrichment is based on the idea that as work becomes more challenging, an employee’s motivation and enthusiasm will increase. In a horizontal organizational structure, it is more appropriate to increase the depth of a job, by adding more autonomy and responsibility, than to promote people and create unnecessary layers of middle managers.

Conveniently enough, one job enrichment activity is to involve field staff in the process of measuring customer satisfaction. To participate in customer satisfaction research, employees need to learn new skills, such as interviewing and analysis techniques, which addresses their desire for staff development. If this indeed results in better customer service, it creates a win-win-win opportunity for management, staff, and customers. The following chapters provide details about appropriate tools for understanding desertion, measuring customer satisfaction and enhancing loyalty.

Managing Customer Loyalty

This guide has addressed what loyalty is, why it’s important, and how to enhance it. The following three chapters build on this knowledge by discussing how to manage loyalty, and present various tools for the task. Managing loyalty involves understanding reasons for customer exits, resolving customer complaints, and gathering information about customer satisfaction. With that knowledge, it is possible to increase customer satisfaction and, ultimately, build customer loyalty. The customer loyalty management system covers three zones of loyalty management:

1. **Understanding defection.** Worse than plain deserters, defectors actually leave your institution for another institution that they perceive as being better than yours. Exit interviews help figure out who’s leaving and why, and customer recovery
strategies can convince some customers to come back. (Chapter 4)

2. **Preventing defection.** Before they defect, or desert, customers are dissatisfied, sometimes for quite a while. Identifying dissatisfied customers and making them happy before they leave will save a great deal of time and money in the long run. (Chapter 5)

3. **Measuring customer satisfaction.** Customers who are satisfied today may not be satisfied tomorrow. For this reason, MFIs must constantly monitor customer satisfaction. When there’s a slip in satisfaction, it’s time to jump in with creative solutions to tackle the problems. (Chapter 6)

In addition, Chapter 7 takes a close look at how to build and use the tools that are described in Chapters 4 through 6.

Each of these chapters is full of tools to help you learn from your customers. There isn’t one way to monitor satisfaction and enhance loyalty, yet it is excessive to try to implement all of the tools. It is up to you to choose the combination of techniques that is right for your institution. In making that decision, consider several dimensions of each tool: cost, frequency of use (on-going or only when necessary), who will administer the tool (the MFI or a third party), and overall effectiveness. If these measures seem too expensive and time consuming, keep in mind that it costs approximately five times as much to find a new customer than to retain an existing one, so it is a worthwhile investment.\(^\text{13}\)

Figure 7 gives you a big-picture view of the steps to increase customer loyalty. Each step is associated with tools in this guide (understanding desertion, preventing defections, measuring customer satisfaction, enhancing customer loyalty).

**Figure 7: Five Steps to Improve Customer Loyalty**

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\(^\text{13}\) Reichheld and Sasser (1990)
Learning from Your Losses

“Give me a fruitful error any time, full of seeds, bursting with its own corrections.”

- Vilfredo Pareto

Losing customers can deal a financial blow to the organization, especially when long-standing customers stop borrowing. If that customer leaves for good, you forfeit short-term and future profits that customers might have delivered. You also lose any referrals that customer might have made. If they leave with a bad taste in their mouths, then they might generate negative referrals by bad mouthing you. And if they defect to another service provider, then you are in effect subsidizing the competition. “This very minute, your best customers and clients are your competitors’ most sought after

While you obviously don’t want to lose good customers, if customers are leaving, you should see the silver lining in that cloud. Lost customers represent a useful source of information about your products and services. The more you understand about why customers are leaving, the better position you will be in to modify existing products, introduce new products, and improve service delivery. And just perhaps, by trying to find out why they left, by listening to them and caring about what they have to say, and by responding to their concerns, you might even be able to woo some of them back.

This chapter accomplishes three primary objectives:

- It provides ways of measuring customer retention so that MFIs can understand the extent to which customers are departing.
- It helps MFIs to look beneath the retention ratio to use exit interviews to learn why they are leaving.
- It discusses ways of using information gleaned from exit interviews to attract former customers back into the fold.

Griffin (1995)
Early Warning Signs

The financial ratios commonly used to evaluate the health of an MFI, like financial self sufficiency and return on assets reflect past performance of the institution, but they aren’t good indicators of how well the institution will do in the future. As players in an emerging industry, microfinance institutions are known for the volatility of their performance. Board members should not wait until the annual financial statements are produced before they determine how well, or poorly, the organization is doing. Instead, managers and directors need to monitor a series of early warning indicators that can help identify possible problems before they bloom into full-fledged crises.

**Portfolio Quality:** All MFIs monitor portfolio quality in some way—repayment rates, delinquency rates, portfolio at risk—but some ways of calculating these ratios are more sensitive than others. If the institution is experiencing rapid growth, or if juvenile loans are a large percentage of the portfolio, then managers can be lulled into a sense of false security. To avoid complacency, MFIs need to: a) shorten the time frame and b) dissect the portfolio.\(^\text{15}\)

*Shorten the Time Frame:* While most MFIs track loans that are 90 days overdue, and many monitor loans that are 30 days late, neither time frame is sufficiently sensitive for short-term loans with frequent repayments. To make sure that you’re on top of things, if your MIS will permit it, shorten the time period to 7 days or even one day. If you cannot track in real-time the percentage of portfolio (or repayments) that is one day late, then have loan officers note when repayments were received late even if those customers have brought their loans up-to-date by the time reports are submitted to the head office. If the organization doesn’t monitor late repayments in addition to loan quality at the end of the month, there may be a budding portfolio quality problem that is masked by diligent loan officers who squeeze repayments from their customers before the books close.

*Dissect the Portfolio:* Although there may not be discernable differences in an MFI’s overall portfolio quality from one month to the next, an analysis of portfolio subsets is likely to reveal that improvements in some areas are masking declines in others. The most common ways of disaggregating the data are by branch and by loan officer, but MFIs might also consider monitoring by business sub-sectors to see if some industries are experiencing problems. Another way of slicing the analysis is by loan number to ensure that performance of new and repeat loans are meeting or exceeding expectations.

**Staff Turnover:** Even if an MFI isn’t experiencing portfolio quality problems, if it starts to lose an increasing percentage of its staff, other problems are probably right around the corner.

**Customer Retention:** One of the difficulties likely to stem from a staff turnover problem is an increase in customer desertion. This indicator, defined in detail in the following pages, can be monitored based on data that is readily available in most microfinance information systems.

**Customer Satisfaction:** Of all the early warning signs, customer satisfaction is used least commonly. As discussed in Chapter 6, regular and scientific surveying of customer satisfaction can provide valuable insight into potential threats, such as poor service, unfulfilled expectations, and inappropriate products. Unfortunately, this warning system cannot be implemented by crunching existing data. Therefore, this method is only appropriate for larger MFIs, particularly those that operate in competitive environments and have the capacity to collect customer satisfaction information.

\(^\text{15}\) CGAP Occasional Paper No. 3 (June 1999), “Measuring Microfinance Delinquency: Ratios Can be Harmful to your Health,” does an excellent job of exploring this topic.


**Measuring Customer Retention**

MFIs track numerous, if not countless, performance indicators. One ratio often overlooked is customer retention. Although it is not a direct indicator of financial performance, a drop in retention is a critical **early warning signal** that trouble may be brewing. Low retention can lead to a reduction or stagnation of average loan size, which can reduce future returns and cause other financial hazards.

Tracking customer retention ratios is inexpensive and serves two purposes. First, it provides a blunt or general indicator of customer satisfaction. Second, it is important in forecasting the overall financial performance of the MFI. To develop accurate financial projections, an MFI has to have information about customer retention so that it can predict the effect on average loan size, which determines revenue, and on the acquisition costs necessary to replace lost customers.

The retention ratio is heavily influenced by the availability of other service providers. The ratio is also influenced by customer behavior: customers may be “resting” between loans, or they may have closed all loan accounts but kept two savings accounts. Because it is context-specific, customer retention is not something that can be easily benchmarked between countries or regions. Consequently, there aren’t industry standards that MFIs should aspire toward. Instead, institutions need to compare their current performance to their past performance to see retention trends over time.

When the institution measures retention regularly, it can take remedial steps as soon as dropout levels increase. Since monitoring customer retention is an easy and inexpensive way to indicate potential problems, all MFIs should include a customer retention ratio as one of their basic monthly indicators.

A drop in retention from one month to the next does not always mean that there is a serious problem. All MFIs experience **natural seasonal variations**. Interpreting retention ratios involves not only monthly trends analysis, but also a comparison of this month to the same month in the previous year. While this seasonal variation is most obvious for MFIs serving agricultural communities, urban traders and manufacturers also experience seasonal differences particularly around festivals and the start of the school year. Information about natural seasonal variations helps the institution to plan ahead for anticipated fluctuations in product demand. This information can also help the MFI to form a marketing plan that reflects customer needs at various times.

Regularly monitoring retention requires a simple and straightforward retention formula. Though there are many to choose from, it is best to use an easy formula based on readily available information. The Consultative Group to Assist the Poorest (CGAP) defines retention as the comparison between the number of customers who have completed a loan within the period and those who repaid a loan within the period and have not (yet) returned for a further loan. This formula can be represented in two ways, presented in

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All MFIs should include a customer retention ratio as one of their basic monthly indicators.
Figure 8. While the first indicator is a little simpler, not all information systems can easily produce the number of loans that were paid off. For more on customer retention formulas, please see Appendix C at the end of this book.

**Figure 8: Customer Retention Formulas**

<table>
<thead>
<tr>
<th>Formula</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1:</td>
<td>Number of follow-up loans issued during the period</td>
</tr>
<tr>
<td>2:</td>
<td>Number of loans issued during period – number of new customers entering during period</td>
</tr>
</tbody>
</table>

This formula begs the question: What period is most appropriate to monitor? While it makes sense to monitor retention rates from one month to the next, if the period being analyzed is that month, the ratio is too sensitive. Wide fluctuations from December to January probably do not reflect a mass exodus of customers, but rather a seasonal adjustment. Even an analysis of the previous three months is not particularly helpful, unless you are comparing quarters between years.

The most useful way of tracking customer retention is on a monthly basis for the previous twelve months, as shown in the right hand column of Figure 9. This even out the seasonal changes and allows for smoother trend lines that are easier to interpret. In this

---

**“Desertion” of Depositors**

Calculating a desertion rate for savings customers can be difficult for several reasons:

- When a savings service is first offered, or the institution is serving customers who are unfamiliar with savings accounts, customers may test the service by depositing funds one day and withdrawing their money the next.
- Because many customers drain their accounts to a bare minimum, but do not bother to actually close them, their accounts may sit dormant for months or even years. Therefore, when estimating the desertion rate for savers, the institution should look at account inactivity (i.e. for passbook savings, no deposits or withdrawals in the past 12 months) as well as account closings.
- The liquidity features of different savings products would determine the period inactivity. For example, the definition of inactivity for a passbook account would be very different than for certificates of deposit (CDs).
- Some customers close and open accounts at the same time. For example, a CD may come due, and rather than renewing it, the customer opens up a liquid account instead.
- An institution also needs to monitor average account balance and dissect the analysis by product and by various subsets of the customer base. An MFI may not see the number of accounts declining, but it may experience declining account balances. Rather than full-fledged desertion, this leakage of balances could reflect a risk management strategy by customers.
case, the trend lines start out negatively in Year 2, but by July the organization has turned things around and shows strong improvement in retention through the end of the year.

**Figure 9: Calculating Retention Rates**

<table>
<thead>
<tr>
<th>End of Month</th>
<th># of Loans Issued</th>
<th># of New Loans</th>
<th># of Repeat Loans</th>
<th>Monthly Retention Rate</th>
<th>Quarterly Retention Rate</th>
<th>Annual Retention Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-98</td>
<td>12045</td>
<td>546</td>
<td>250</td>
<td>296</td>
<td>48.3%</td>
<td></td>
</tr>
<tr>
<td>Feb-98</td>
<td>12189</td>
<td>467</td>
<td>311</td>
<td>156</td>
<td>48.3%</td>
<td></td>
</tr>
<tr>
<td>Mar-98</td>
<td>12447</td>
<td>921</td>
<td>534</td>
<td>387</td>
<td>58.4%</td>
<td></td>
</tr>
<tr>
<td>Apr-98</td>
<td>13065</td>
<td>1213</td>
<td>525</td>
<td>688</td>
<td>115.6%</td>
<td>77.9%</td>
</tr>
<tr>
<td>May-98</td>
<td>13260</td>
<td>804</td>
<td>548</td>
<td>256</td>
<td>42.0%</td>
<td>71.3%</td>
</tr>
<tr>
<td>Jun-98</td>
<td>12898</td>
<td>662</td>
<td>345</td>
<td>317</td>
<td>31.0%</td>
<td>56.6%</td>
</tr>
<tr>
<td>Jul-98</td>
<td>13079</td>
<td>890</td>
<td>548</td>
<td>342</td>
<td>48.2%</td>
<td>39.1%</td>
</tr>
<tr>
<td>Aug-98</td>
<td>13417</td>
<td>728</td>
<td>534</td>
<td>194</td>
<td>49.7%</td>
<td>40.2%</td>
</tr>
<tr>
<td>Sep-98</td>
<td>13743</td>
<td>837</td>
<td>491</td>
<td>346</td>
<td>67.7%</td>
<td>54.8%</td>
</tr>
<tr>
<td>Oct-98</td>
<td>14018</td>
<td>822</td>
<td>503</td>
<td>319</td>
<td>58.3%</td>
<td>59.3%</td>
</tr>
<tr>
<td>Nov-98</td>
<td>14721</td>
<td>1610</td>
<td>651</td>
<td>959</td>
<td>105.7%</td>
<td>82.6%</td>
</tr>
<tr>
<td>Dec-98</td>
<td>15510</td>
<td>1821</td>
<td>712</td>
<td>1109</td>
<td>107.5%</td>
<td>96.0%</td>
</tr>
<tr>
<td>Jan-99</td>
<td>15280</td>
<td>601</td>
<td>275</td>
<td>326</td>
<td>39.2%</td>
<td>86.4%</td>
</tr>
<tr>
<td>Feb-99</td>
<td>14838</td>
<td>514</td>
<td>342</td>
<td>172</td>
<td>18.0%</td>
<td>57.0%</td>
</tr>
<tr>
<td>Mar-99</td>
<td>15231</td>
<td>1013</td>
<td>587</td>
<td>426</td>
<td>68.7%</td>
<td>38.4%</td>
</tr>
<tr>
<td>Apr-99</td>
<td>16007</td>
<td>1334</td>
<td>578</td>
<td>757</td>
<td>135.6%</td>
<td>63.5%</td>
</tr>
<tr>
<td>May-99</td>
<td>16333</td>
<td>884</td>
<td>603</td>
<td>282</td>
<td>50.4%</td>
<td>84.3%</td>
</tr>
<tr>
<td>Jun-99</td>
<td>16502</td>
<td>728</td>
<td>380</td>
<td>349</td>
<td>62.4%</td>
<td>82.8%</td>
</tr>
<tr>
<td>Jul-99</td>
<td>16916</td>
<td>979</td>
<td>603</td>
<td>376</td>
<td>66.6%</td>
<td>59.8%</td>
</tr>
<tr>
<td>Aug-99</td>
<td>17402</td>
<td>801</td>
<td>587</td>
<td>213</td>
<td>67.8%</td>
<td>65.2%</td>
</tr>
<tr>
<td>Sep-99</td>
<td>17826</td>
<td>921</td>
<td>540</td>
<td>381</td>
<td>76.6%</td>
<td>70.5%</td>
</tr>
<tr>
<td>Oct-99</td>
<td>18228</td>
<td>904</td>
<td>553</td>
<td>351</td>
<td>69.9%</td>
<td>71.9%</td>
</tr>
<tr>
<td>Nov-99</td>
<td>19114</td>
<td>1771</td>
<td>716</td>
<td>1055</td>
<td>119.2%</td>
<td>94.8%</td>
</tr>
<tr>
<td>Dec-99</td>
<td>20036</td>
<td>2003</td>
<td>783</td>
<td>1220</td>
<td>112.8%</td>
<td>106.4%</td>
</tr>
</tbody>
</table>

In this example, there are dramatic fluctuations in the monthly retention rate, with peaks occurring in April and at the end of the year. When the retention rate exceeds 100 percent, it indicates that former customers have returned for a repeat loan after a “resting” period. Many customers do not want to automatically renew their loan when the previous one is repaid. Instead, they wait until there is a specific need—either a business opportunity such as stocking up for the holiday season or a personal need such as paying school fees—before accessing a subsequent loan. This resting phenomenon is another reason why monthly retention has little significance, but annual retention, tracked on a monthly basis, is very valuable.

As with other performance indicators, it is important to compare retention ratios for various subsets of the portfolio. Low retention in some branches or by some loan officers
may mean that there is a customer service problem that warrants an intervention. The mystery shopping tool described in Chapter 6 is one way to get to the root of faltering customer retention rates in specific branches.

Understanding Desertion

Despite the intrinsic value of the customer retention rate as an early warning indicator, this ratio cannot tell the organization how to solve the problem because it does not explain why customers are deserting. So, when retention rates suggest trouble, the MFI must uncover the reasons for desertion. These reasons do not always relate to satisfaction. In the following examples, only about half of the dropouts left because they were dissatisfied with the institution’s products and services.

The exit interview is the most important means of collecting information to improve the quality of your products and services.

- ABA surveyed 422 former customers to find out why they left. The organization determined that 46 percent of the dropouts left because the loan sizes and terms were not suitable, 24 percent left because they obtained another job, 19 percent stopped their business, and 11 percent deserted for various other reasons.\(^\text{17}\)

- PRODEM conducted a survey of 1,400 customers and discovered that 42 percent left because of problems with their solidarity groups, 20 percent left temporarily due to sales cycles, 8 percent left because of personal problems, 7 percent due to market problems, 5 percent because of problems with the bank’s services or products, and 18 percent left for other reasons.\(^\text{18}\)

- BancoSol found that 30 percent of its deserters defected to the competition, primarily because of BancoSol’s high interest rates and the inflexibility of the group methodology that the institution used at the time. Half of the deserters were resting and intended to return in the near future for another loan, and the remaining 20 percent did not expect to need a loan in the next year.\(^\text{19}\)

- Compartamos conducted a series of exit interviews and found that 22 percent of its lost customers departed for personal problems. Lack of time, required weekly meetings, and distance accounted for 19, 17, and 12 percent of dropouts respectively; 10 percent left due to default; 8 percent because the interest rate was too high; and poor business accounted for the remaining 6 percent.\(^\text{20}\)

These cases show us that not every customer who deserts is unhappy with products and services. It is inappropriate to try to lure all lost customers back into the fold. However,

\(^{17}\) Churchill (1997).
\(^{18}\) Ibid.
\(^{19}\) Self-reported data (1999).
\(^{20}\) Self-reported data (1999).
for those 30 to 50 percent of deserters who left due to dissatisfaction, it is worth the effort to get them back. If only these MFIs had known why customers were unhappy before they defected, the institutions could have done their best to increase the satisfaction of those customers and encourage them to stay on.

Reasons for leaving the institution are various and examining them helps the institution to learn how to better serve its customers. Exit interviews and the customer recovery process are tools that help MFIs to understand why good customers are deserting, and what to do about it.

**Desertion Monitoring Tool: Exit Interviews**

Exit interviews enable the institution to learn what lies behind the retention ratio by determining who is leaving and why. Of all the tools discussed in this document, the exit interview (or lost customer analysis) is the most important means of collecting information to improve the quality of your products and services. There are two objectives of exit interviews: (1) to learn at the point of departure, when the customer is potentially most dissatisfied, why he or she chose to leave, and (2) to gain (some) customers back by using the information to develop a customer recovery process.

Exit interviews can be performed either as needed or on a regular basis. Smaller MFIs and organizations with limited MIS capabilities might conduct exit interviews when they begin to experience a retention problem. In this case, they should conduct a rigorous sampling exercise (see Chapter 7) of lost customers so that the findings from the study are representative. A possible downside of this “as needed” approach is that there is a built-in delay between identifying a retention problem and learning what lies behind it. In addition, it may be difficult to find some former customers and their memories of why they left may not be particularly fresh.

Larger organizations, particularly those that operate in competitive markets, should consider integrating exit interviews into their normal course of action. Whenever someone makes his or her final loan repayment, the loan officer or teller could conduct a simple interview. This makes it possible for the MFI to communicate with and learn from its entire customer base on a regular basis, including customers who are interested in renewing their loans. This immediate action is helpful because it could pick up signs of dissatisfaction before they mutate into defection. Often it is not one incident or issue that causes customers to leave, but rather it is a series of little things that build up over time. The downside of the integrated approach is that it is very costly.

**Learning from Losses at Kafo Jiginew**

With the AIMS exit interview tool, Kafo Jiginew in Mali learned that half of its customers who left did so in May, just before the rainy season. This knowledge helped the institution plan ahead in terms of its cash flow. Another 25 percent of customers left because their businesses were not profitable. With this information, Kafo Jiginew could potentially develop a training program to improve customers’ businesses skills and enhance customer loyalty. It could also improve screening methods to ensure that it is lending only to entrepreneurs who have good potential for profitability.

- From The SEEP Network’s *Learning from Customers: Assessment Tools for Microfinance*
to interview, code, and input data for every single customer after every single loan. MFIs that are struggling to improve efficiency may see this as an unnecessary expense. When exit interviews are conducted with each customer, they resemble the customer satisfaction surveys discussed in Chapter 6.

This chapter focuses on information gathered from former customers on an occasional basis in response to an identified retention problem. The following information should be gathered:

- **After how many loans did the customer drop out?** Answers will help the institution forecast when a customer will most likely drop out, and formulate incentives for customers to remain with the institution after that period.

- **How did the customer use the loan?** The customer’s business type, loan usage, or another specific factor may have affected the decision for a customer to leave the institution.

- **Why did the customer leave?** This information will disaggregate dropouts according to the cause of desertion. If most customers are leaving due to poor business or personal reasons, there is little the institution can do to win them back, although this information may suggest changes to the screening techniques.

- **What are they doing now?** It is important to learn whether you have lost the customer to the competition, either formal or informal, and if so, what is it that the customer prefers about the services she is currently receiving.

- **What would convince them to come back?** Since you’ve gone to all this trouble to find out what’s on their minds, they may be persuaded that you actually care about them. They may also have tangible suggestions on how to get them back, some of which you might be willing to implement.

### Compartamos: Recovering Lost Customers

As a result of Compartamos’ 1999 exit interviews, the institution discovered that half of all deserters left due to dissatisfaction with products and services. The exit interviews also pointed to the products features that were causing the most problems. With this information, management knew not to change anything regarding savings services, but instead to adjust services related to loan terms, weekly payments, group meetings, and interest. Compartamos also learned that 70 percent of dropouts would be willing to re-enter the program under the right conditions.

Figure 10 provides the format of the Compartamos exit interview.
The objective of this questionnaire is to understand the fundamental reason of your departure from the program. We are interested in your comments to be able to offer services that meet your needs.

Please mark the appropriate response with an “x.” Each question may have a maximum of three responses.

<table>
<thead>
<tr>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group Name</td>
</tr>
<tr>
<td>Township</td>
</tr>
<tr>
<td>Date</td>
</tr>
</tbody>
</table>

1. **What type of business do you run?**
   - Commercial
   - Service
   - Production
   - Specifying other:

2. **How many times have you borrowed from Compartamos?**
   - One
   - Two
   - Three
   - Four
   - Five
   - Six or more

3. **How do you use the loans?**
   - Business
   - Family
   - Construction
   - Debt

What was the fundamental reason for your departure from the program?

<table>
<thead>
<tr>
<th>Loan officer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weekly meetings</td>
</tr>
<tr>
<td>Distance</td>
</tr>
<tr>
<td>Time</td>
</tr>
<tr>
<td>Savings</td>
</tr>
<tr>
<td>Interest Rate</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Late payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal problems</td>
</tr>
<tr>
<td>Poor management</td>
</tr>
<tr>
<td>Bad service</td>
</tr>
<tr>
<td>Few Sales</td>
</tr>
<tr>
<td>Specifying other:</td>
</tr>
</tbody>
</table>

4. **Regarding the last question: What do you recommend we do to improve our services?**

5. If you could change something about the loan product, what modifications would you make?
   - Term
   - Interest Rate
   - Amount
   - Meetings
   - Savings
   - Procedures

<table>
<thead>
<tr>
<th>No. of group members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weekly payments</td>
</tr>
<tr>
<td>Specifying other:</td>
</tr>
</tbody>
</table>

6. **Right now, are you receiving a loan?**
   - Yes
   - No

7. **If yes, from whom?**
   - Spouse or Companion
   - Children
   - Relative
   - Friend
   - Moneylender
   - Cooperative

<table>
<thead>
<tr>
<th>Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
</tr>
<tr>
<td>Credit Union</td>
</tr>
<tr>
<td>Specifying other:</td>
</tr>
</tbody>
</table>

8. **If you are not receiving a loan now, where will you receive one in the future?**
   - Spouse or Companion
   - Children
   - Relative
   - Friend
   - Moneylender
   - Cooperative

<table>
<thead>
<tr>
<th>Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
</tr>
<tr>
<td>Credit Union</td>
</tr>
<tr>
<td>Specifying other:</td>
</tr>
</tbody>
</table>

9. **Would you consider returning to Compartamos for future loans?**
   - Yes
   - No
To get to the root cause of problems, the interviewer needs to develop certain probing techniques. For example, he might ask for the former customer to describe a situation in which she had a bad (or good) experience with your organization, and then creatively and repeatedly ask “why” to determine the real reason for the negative (or positive) experience. A customer may say that the loan size was too small, but after additional questioning about what loan size would have been appropriate and what she would have used the loan for, the interviewer determines that the customer wanted a housing loan, not a business loan. So it wasn’t a loan size problem, it was a loan purpose problem.

Your institution must be careful not to attempt to win back customers who have recognized that they cannot benefit from your services. You may even want to skip exit interviews for customers who have bad debts and chronic repayment problems, unless it appears that poor screening practices led to a battery of customers with these attributes. Also, the interview doesn’t have to just focus on negative issues; researchers can ask what services were beneficial and what they liked about the organization. Refer to the “Surveys” section of Chapter 7 to learn more about how to ask the right kinds of questions and how to use results.

**Using Exit Information for Customer Recovery**

The process of learning why customers left has the secondary objective of trying to encourage them to return. If exit interviews identify a common set of problems—such as the large segment of PRODEM’s customers who were having problems with their groups—then the organization can launch an appropriate response and devise a marketing strategy for this group. This type of **responsive marketing** is more effective if it occurs soon after the data collection process. The box on the next page describes how an MFI might use exit interview results to develop a customer recovery initiative.

Of course, the institution cannot develop an appropriate response without conducting a thorough cost-benefit analysis of the proposed plans. Market research and use of customer surveys (discussed thoroughly in Chapter 6) can help determine the most appropriate response, one that is beneficial to both the customers and the institution. When customers see that their needs and concerns are being met, they just may think twice about finding other sources of financial services.
MicroBank Exit Interview Results

In response to a growing desertion problem, MicroBank formed a customer service committee. The committee’s first step was to commission a lost customer analysis, which it undertook with a marketing professor at the business school whose class was looking for an applied research project. After some starts and stops, the MIS department was able to produce a list of the customers who repaid their loans during the past twelve months and did not request a repeat loan (one of the problems was making sure that the list excluded customers whose repeat loan application was denied as well as those with a poor repayment record who would have been denied had they applied).

<table>
<thead>
<tr>
<th>Why did you stop borrowing? (primary reason)</th>
<th>1 Loan (n=120)</th>
<th>2 &amp; 3 Loans (n=106)</th>
<th>&gt; 3 Loans (n=264)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Problems with the group</td>
<td>22.5%</td>
<td>14.2%</td>
<td>12.1%</td>
</tr>
<tr>
<td>No longer needed a loan</td>
<td>2.5%</td>
<td>10.4%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Loan sizes too small</td>
<td>25.0%</td>
<td>29.2%</td>
<td>25.8%</td>
</tr>
<tr>
<td>Fees and interest too high</td>
<td>10.8%</td>
<td>13.2%</td>
<td>16.7%</td>
</tr>
<tr>
<td>Business failed</td>
<td>5.0%</td>
<td>6.6%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Resting. plan to come back in the next 12 months</td>
<td>8.3%</td>
<td>3.8%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Inconvenient (i.e., too far, too much time)</td>
<td>15.8%</td>
<td>18.9%</td>
<td>20.5%</td>
</tr>
<tr>
<td>Poor health</td>
<td>3.3%</td>
<td>1.9%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Other</td>
<td>6.7%</td>
<td>1.9%</td>
<td>4.9%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Are you currently borrowing for your business?</th>
<th>(n=109)</th>
<th>(n=97)</th>
<th>(n=235)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not currently borrowing/don’t need a loan</td>
<td>27.5%</td>
<td>20.6%</td>
<td>21.7%</td>
</tr>
<tr>
<td>Not borrowing/want a loan</td>
<td>35.8%</td>
<td>34.0%</td>
<td>30.2%</td>
</tr>
<tr>
<td>Borrowing from informal sources (friends, family, moneylender)</td>
<td>24.8%</td>
<td>17.5%</td>
<td>14.9%</td>
</tr>
<tr>
<td>Borrowing from formal competition (bank, NGO, etc)</td>
<td>11.9%</td>
<td>27.8%</td>
<td>33.2%</td>
</tr>
</tbody>
</table>

Based on the results of the survey, presented above, the committee made two major recommendations. First, MicroBank should develop a flexible group product for repeat borrowers in good standing. The committee wasn’t ready to make the leap into individual lending, but they saw an opportunity to meet customers’ needs by loosening the terms and conditions, including fewer repayments, lower interest rates for those with excellent repayment histories, and larger loan sizes based on a careful cash flow analysis. MicroBank initiated a pilot test in one branch to analyze the impact of the proposal.

The second recommendation was to launch a customer recovery initiative. The initiative began with a personalized letter from the Executive Director to all 2029 customers who left MicroBank in good standing during the past two years. The letter stated that because of the valuable feedback provided by many former MicroBank customers in recent interviews, the bank was launching a new Premium Loan Product, and asked them to consider borrowing from MicroBank again. The second prong to the recovery initiative was a visit by the loan officer to reinforce the content of the letter.

The results of the recovery initiative were very successful, in fact too successful. Nearly 40 percent of the lost customers were attracted back to MicroBank during the next three months. This sudden surge in demand caught some of the branches off-guard and understaffed, creating unfortunate delays in application processing. It also caught the Finance Department off-guard by putting a squeeze on liquidity. If they could have done it differently, the committee would have conducted a more careful analysis of the potential impact, staggered the mailing on a branch-by-branch basis, and would have rotated extra staff through the branches to deal with the demand.
Preventing Defections

“A longtime client or customer is yours to keep or yours to lose. By the time an account has gotten to the repeat client or customer stage, there is a history and both parties have invested a lot. After selling to this person over a period of time, you know... his or her needs, just as this customer knows you, your staff, and your company. A considerable investment has been made by both parties.”

- Jill Griffin, President, The Marketing Resource Center Inc.

Chances are that if good customers are dissatisfied with the offerings of your institution, they will borrow elsewhere. When an unhappy customer leaves, it is estimated that she will tell at least ten other people of the bad experience. Often, the institution doesn’t suspect that a problem exists in the first place, but the result is negative advertising, declining profits, and lost opportunities to serve customers. The good news is that this scenario is avoidable. By actively soliciting complaints, MFIs can spot dissatisfied customers, resolve their complaints, find ways to meet their needs, and ultimately retain highly-valuable repeat customers who will spread the good news about your institution.

The best way to prevent defection is by listening to customer complaints and quickly acting upon them, through the following steps:

- Create channels for dissatisfied customers to complain
- Encourage all customers to use these channels
- Personally attend to customers who are dissatisfied
- Quickly resolve customer complaints to turn dissatisfied customers into long-term, happy customers who will be loyal to the institution

Following these steps will allow MFIs to avoid costly defections while enhancing their long-term relationships with customers who are crucial to lasting growth and profitability. This chapter explores the nature and sources of complaints, and suggests ways to actively solicit complaints and proactively resolve them to leave a trail of satisfied, repeat customers in your wake.

21 Barlow and Møller (1996).
The Anatomy of Complaints

In handling complaints, it is helpful to have foresight into the range of complaints you may encounter. Different complaints require different resolution processes. For example, if a customer expresses concerns about the high interest rate, a loan officer can sympathize, but probably can’t fix the problem. However, if there was a paperwork mix-up that caused a delay in a customer’s loan disbursement, then branch staff should quickly resolve the issue.

Figure 11 provides a rough map of what kinds of complaints to expect and a general idea of what to do with them. Using this framework, MFIs might consider developing their own tailored guidelines to clearly indicate to branch staff what they can and cannot resolve.

Not all complaints have immediately apparent answers. Some can (and should) be solved immediately, while others require some investigation. The most important response to any complaint is concern and appreciation. A complaint not only provides useful feedback, but it also creates an opportunity for you to exceed the customer’s expectations. With this in mind, you should make it easy for the dissatisfied customer to complain.

**Figure 11: Mapping Complaints**

<table>
<thead>
<tr>
<th>Type of Complaint</th>
<th>Examples</th>
<th>Who is Responsible?</th>
<th>Mode of Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Complaint</td>
<td>• Personal problems with group members</td>
<td>Branch office</td>
<td>Immediate</td>
</tr>
<tr>
<td></td>
<td>• Don’t like my loan officer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service Complaint</td>
<td>• Loan officer is late to meetings</td>
<td>Branch office</td>
<td>Immediate</td>
</tr>
<tr>
<td></td>
<td>• Cashiers are rude</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Turn around time too slow for repeat loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Error Complaint</td>
<td>• Savings balance posted incorrectly</td>
<td>Branch office</td>
<td>Immediate</td>
</tr>
<tr>
<td></td>
<td>• Mistakenly charged for service</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Infrastructure</td>
<td>• Branch is not regularly cleaned</td>
<td>Branch office</td>
<td>Depends on severity and immediate ability to solve</td>
</tr>
<tr>
<td>Complaint</td>
<td>• Not enough chairs in the waiting room</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional Infrastructure</td>
<td>• The office closes too early</td>
<td>Branch/ Headquarters</td>
<td>If there are enough complaints, research possibilities</td>
</tr>
<tr>
<td>Complaint</td>
<td>• Branch locations are inconvenient</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product Complaint</td>
<td>• Interest rate too high</td>
<td>Headquarters</td>
<td>If there are enough complaints, research possibilities</td>
</tr>
<tr>
<td></td>
<td>• First loan is too small</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Don’t like forced savings</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The Advocates and the Antagonists

There is no doubt that customers will talk about the services they receive from your MFI; it is up to you whether the conversations will concentrate on the good or on the bad. If you’re going to generate free word-of-mouth advertising, it would be best if it were positive. Advocates of your MFI will talk enthusiastically about the helpful and friendly teller in window six, they will recommend your microenterprise loan product to a friend in the business, and they will rave about how easy it is to make loan payments at the local branch.

Antagonists, on the other hand, are customers who feel wronged and want the whole world to know about their awful experiences. People love to tell woeful stories, and if your MFI gives a customer a reason to do so, it is almost certain that he will take the opportunity to tell people, who will tell other people, and so on. How is an antagonist born? Sometimes, the antagonist is first a benign complainer, and when your responses to his complaints are either inadequate or uncaring, he becomes angry and tells the whole world. Sometimes, the antagonist is a customer who silently endured poor service for a number of months or even years, and who finally snapped.

The best way to turn all customers into advocates—and even to win some antagonists back to the other side—is to first encourage customers to complain and then to treat their complaints, and your responses to them, with utmost seriousness and sincerity.

Identifying Dissatisfied Customers

By identifying dissatisfied customers before they have the opportunity to become antagonists, you can turn the most unhappy persons into happy patrons. You can even bring an antagonist back into your good graces, if you know how to find her. Many signs point to the customer who is so dissatisfied that she is on the brink of defection; sometimes frontline staff just don’t know where to look for those signs. MFIs that want to make it easier to identify the dissatisfied customer adopt instruments that draw attention to these customers, namely:

- An easy-to-use complaints and suggestions system
- A customer service desk
- A customer feedback solicitation strategy
- Customer advisory boards

Even if your institution has undertaken meticulous market research and analysis, customers will still find problems with the services your institution offers. Inevitably, there will be dissatisfied customers who can suggest ways to tweak your products so you can meet customer expectations and improve service. After careful analysis, many of these suggestions will prove useful, feasible, and constructive for both you and your customers.
Customers become highly satisfied and ultimately loyal when the MFI meets and exceeds their expectations. Even disgruntled customers can become your biggest fans if you pay attention to their needs and find creative solutions to their complaints. But before you can satisfy the dissatisfied, you first have to identify them.

To effectively seek out customer complaints, MFIs should adopt the philosophy that complaints are good for business. This philosophy includes the following tenets:

- Complaints are welcome, and bearers of negative comments are thanked for the helpful information they provide.
- Complaints are useful because they flag dissatisfied customers and allow the institution to take preventive action before the customer defects.
- Complaints help improve products and services.
- By encouraging complaints, the institution broadens its scope of knowledge about its customers, which is helpful to its own success.

BancoADEMI and PRIDE Tanzania make it easy for their customers to give feedback. At BancoADEMI, customers are made to feel at home from the very beginning. During her first visit to a branch, the customer meets with the branch manager, who immediately offers her a cup of coffee, and later gives her the direct phone number to the branch and encourages her to use it whenever there is a problem. A trained person always answers the phone, greets the customer, and does his best to take care of her needs. At PRIDE Tanzania, customers are known to be outspoken about their needs. One senior official attributes this outspokenness to the close relationships forged between customers and loan officers during the weekly one-hour group meeting that all customers must attend. Loan officers report customer complaints and suggestions to their branch managers, who discuss them at quarterly management meetings.

For most people, it is more natural to avoid potential conflicts than to solicit feedback and encourage complaints. If staff learn how to identify and approach dissatisfied customers, the process of gathering feedback will be more effective. While they will certainly recognize obvious dissatisfaction, such as demanding to see the manager, most dissatisfied customers don’t complain. But their body language, like sighing and frowning, can give them away. In these circumstances, loan officers need to approach a potentially dissatisfied customer to ask if everything is okay and if there is anything he can do to help. If the customer is unwilling to talk, the loan officer can suggest other communication channels, which are explored in greater depth about later in this chapter.

Sometimes dissatisfaction can be seen rather than heard. The complaint solicitation strategy involves watching out for dissatisfied customers and encouraging them to use the customer feedback instruments. Signs of dissatisfaction include the sudden withdrawal of funds from a savings account, a long period without requesting a repeat loan, and body language that depicts frustration and anger. These actions may come about directly before a customer is about to defect, and therefore intervention is imperative! To encourage loan officers to be proactive in soliciting complaints, give a yearly award to the loan officer who is most committed to soliciting and resolving customer complaints.
The following tools offer some ways to formalize the processes described above, and offer other ways to alert management to customer discontent. These tools not only shoot up red flags to warn staff of potential defectors, but they also offer an alternative to customers who would otherwise feel there was nowhere to turn for help. Because each tool has advantages and disadvantages, a combination of approaches is recommended.

**Tools to Encourage Complaints**

Although it sounds strange, it is in the institution’s best interests to generate complaints. Complaints are gems of information that can ultimately improve products and services. To take full advantage of their potential, it may be helpful to designate someone as the **customer relations manager** to oversee the implementation of complaint soliciting tools. A **customer service committee**, consisting of a team of employees representing different departments, can also serve a useful purpose in terms of research, analysis, and complaints resolution. A customer service committee is a cross-functional team comprised of staff members of various levels (for example, a manager from MIS, a human resources manager, a product development specialist, a branch manager) who can bring various perspectives to the task of customer satisfaction. The team can meet monthly or as necessary to ensure that the customer satisfaction strategy is carried out.

The following tools are designed to generate customer complaints and feedback. Figure 12 highlights some important characteristics of each tool.

**Figure 12: Tools to Encourage Complaints**

<table>
<thead>
<tr>
<th>Tool</th>
<th>Relative Cost</th>
<th>In-House or Third Party?</th>
<th>Overall Effectiveness</th>
<th>Frequency of Use</th>
<th>For what size institution?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complaints and Suggestions System</td>
<td>Low</td>
<td>In-House</td>
<td>Medium</td>
<td>Always</td>
<td>All Sizes</td>
</tr>
<tr>
<td>Client Advisory Board</td>
<td>Low</td>
<td>In-House</td>
<td>Medium</td>
<td>As Needed</td>
<td>Large</td>
</tr>
<tr>
<td>Complaint Solicitation Strategy</td>
<td>Low</td>
<td>In-House</td>
<td>Medium</td>
<td>Always</td>
<td>All Sizes</td>
</tr>
<tr>
<td>Customer Service Desk</td>
<td>Medium to High</td>
<td>In-House</td>
<td>Medium to High</td>
<td>Always</td>
<td>Large</td>
</tr>
</tbody>
</table>

**Tool #1: Create a Complaint and Suggestion System**

A complaint and suggestion system provides a communication channel for unhappy customers. It enables them to share their dissatisfaction with the institution and (hopefully) to suggest ways to improve conditions. A complaint and suggestion system typically consists of comment cards, a receptacle for the cards, and an attention-getting display to encourage its use. Comment cards should have ample room for all complaints.
and suggestions. The display might say something like, “We care about your concerns,” to let customers know that you value their opinions. Figure 13 provides a sample comment card.

Figure 13: Sample Customer Comment Card

CUSTOMER COMMENT CARD

Thank you for taking the time to share your concerns with us.

Comments:

Suggestions:

Name (optional):

Your concerns will be read and documented by our staff. We will review the problem and take appropriate action. If you provide your name, we will contact you personally to ensure that your concerns are addressed.

✦ Advantages. A complaint and suggestion system is always available for customer use and to fill out a card takes only a few moments. When placed in a prominent location in the branch office, a complaints and suggestions box not only serves as a receptacle for customer feedback, but it also serves as a conspicuous reminder of the institution’s commitment to customer satisfaction. The possibility to fill out a card anonymously may also encourage complaints, since some customers may not feel comfortable expressing complaints in person or vocally.

✦ Disadvantages. Many times when customers visit a branch, even if they have a comment to add to the box, they are operating within a short time frame and cannot fill out a card. Also, complaining is discouraged in many cultures. Therefore, results will be skewed to reflect the views of the most dissatisfied customers whose very negative experiences compelled them to complain. This method is not useful for illiterate customers.

Tool #2: Establish a Customer Service Desk

☑ Tips and Suggestions. An additional method to persuade customer participation is to pick a weekly suggestion, post it on a bulletin board, and explain how it will be implemented. This way, customers will gain confidence that the MFI is responding to their needs and concerns. The MFI can also post positive feedback that it receives, which will further boost its reputation for quality customer service. As a further incentive, give monthly rewards to customers with the best suggestions.
A customer service representative, prominently positioned at a desk in each branch, is a live version of the complaints and suggestions box. The customer service representative is trained to listen to customers and respond to their complaints. As with the complaints and suggestions system, the customer service desk includes a sign that says, “We care about your and an eye-catching display about the institution’s commitment to customer satisfaction. It is best if the customer service representative has sufficient authority to quickly solve customer complaints. To make the position most cost-effective, the customer service representative can assume other responsibilities, such as welcoming new customers and opening new accounts.

**Advantages.** The customer service desk provides an easy-access channel for customers to voice their concerns and resolve their complaints. Often, when a customer is unhappy, he feels (often rightfully) that there is no one who can address his concerns. Many times, customers will simply leave rather than taking the time to find out whom to talk to. The option to talk to the representative is also useful for illiterate customers.

**Disadvantages.** The customer service representative will undoubtedly face periods of low volume. This problem, however, can easily be remedied by giving him various other roles, including stepping in for employees on lunch breaks or when there is high volume at the cashiers. A dedicated customer service representative can only be justified in large branches; in smaller offices, the branch manager can fulfill this function.

---

**Tool #3: Implement a Complaint Solicitation Strategy**

Since credit officers and other frontline staff have the most contact with customers, they are in an ideal position to observe customer preferences, needs, and sources of dissatisfaction. Customers will casually comment on operations while making loan repayments or filling out loan applications, and frontline employees have to keep an open ear to customers’ thoughts. Not only are employees in an ideal position to identify dissatisfied customers, they are also in an ideal position to suggest solutions that will make customers happier. To encourage this behavior and boost customer satisfaction, MFIs could reward loan officers who make the best suggestions.

---

Requests Trickle Up at CERUDEB

Centenary Bank in Uganda keeps a suggestions box in every branch. Complaints and suggestions often include small requests that are obvious to customers but do not occur to management, such as more frequent branch cleaning or more chairs in the waiting room.
The customer information generated by your staff members is most valuable if it is documented, collated and analyzed. Caja Los Andes in Bolivia uses a card similar to the one illustrated in Figure 14 to record complaints overheard by field staff. At Caja Los Andes, the reports go to the marketing department for analysis. As with other methods of gathering customer data, to be useful the information is entered into a database. Even taking into account the time it takes to make database entries, this method of market research is relatively inexpensive.

**Advantages.** The complaint solicitation strategy requires little infrastructure; as long as frontline staff pay attention to customer comments and document feedback, this system should allow the customer service committee, the customer relations manager, or the relevant responsible party to keep tabs on trends in customer sentiment.

**Disadvantages.** The complaints solicitation strategy relies primarily on vociferous customers who want their needs heard. The results will likely be biased in a couple of ways. First, because the feedback depends on the relationship forged between loan officer and customer, what gets said, when, and to whom will depend on how the level of comfort customers have with their loan officers. The second bias results from filtration through the loan officer’s point of view when she is reporting customer comments. If complaints are about the loan officer, she is unlikely to draw attention to them.

![Figure 14: Sample Complaint Solicitation Report Card](image)

---

**Complaint Solicitation Report Card**

Employee’s name: **John Barrett**  
Date: **June 15**  
Comment or observation of customer: **Observed one of my customers getting into a loud argument with one of the cashiers**  
What steps did you take? **When the transaction was complete, I went to the customer and asked her if everything was all right. She told me that the cashier could not provide her with any small change, which she needed for her market stall. I told her to talk to the customer service representative and/or fill out a customer comment card, and that someone would definitely get back to her about the situation.**  
How did the customer respond? **She took my advice. In fact, she went to the representative and filled out a comment card. She really felt like she was receiving poor service.**  
What suggestions do you have to permanently resolve the situation? **I’ve heard this complaint before. Since it isn’t difficult to provide small bills, and since the request is legitimate, I think we should make the effort to accommodate our customers in this case.**
**Tool #4: Institute a Customer Advisory Board**

Customers are an effective and reliable source of advice for finding ways to prevent defections. A customer advisory board can formalize this function. The advisory board consists of a small group of customer representatives who meet periodically to discuss the current state of affairs in the institution from the customers’ point of view. A customer advisory board assumes a preventive role for customer dissatisfaction, pinpointing small problems before they become sources of major disappointment. The advisory board can provide ideas for product or service innovations, alert the MFI to the greatest sources of customer dissatisfaction, and otherwise act as a voice for customers. Unlike focus groups, a customer advisory board consists of a fixed or rotating group of customers. Since not everyone feels comfortable complaining directly to staff members, customers need to know that they can share their concerns with their local representatives on the customer advisory board.

During the meeting, advisory board members introduce topics, such as, “A lot of people are saying that MicroBank is too strict with collateral requirements for business loans.” Other members of the board can comment, and then the next suggestion is discussed. Advisory board members should actively solicit feedback from other customers by talking to five to ten of them before each meeting.

**Advantages.** The advisory board meetings provide the MFI with information straight from the customers’ mouths. This is a low-cost system that allows customers to share in-depth information and also empowers customers to help shape the future of the MFI. Their involvement increases ownership and enhances loyalty.

**Disadvantages.** Since the advisory board consists of only a few customers, their comments will not necessarily reflect the wants and needs of all. The board should recognize that, although all suggestions and

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**From the Horse's Mouth?**

*The Limit of Senior Management Fact-Finding Missions*

Many Executive Directors and other senior managers take great pride in keeping in touch with the feelings of their customers by making regular trips to branches. During these trips, they may see a couple of businesses in operation, talk to a few customers in the office, and perhaps even participate in a focus group-like session. While these outings are very important for staff, customers, and management alike, managers need to be very careful about how they interpret the comments that they hear. Opinionated and outspoken customers tend to make strong impressions on senior management, yet their comments are not always representative of customer sentiment. Management needs to be careful not to rely heavily or exclusively on their personal market research techniques. Their conclusions should be triangulated with the findings from additional sources of customer feedback.
recommendations will be considered, each must pass a test of rigorous market analysis before implementation.

**Complaint Resolution**

With these tools, your institution identifies dissatisfied customers by persuading them to complain to you, which does two good things. First, it gives customers a voice, and by doing so empowers them to shape their financial institution. Second, by giving your customers this voice, these tools allow you to solve problems before they cause customers to desert.

Customers want to feel that their needs are a priority to the institution. When the MFI responds to complaints in the appropriate manner, it restores the customer’s faith in the institution, thereby creating loyal customers.

Responding to complaints and suggestions should be written into one person’s job description (e.g. the customer service representative) so that they are uniformly addressed in a timely manner. However, all staff members should be trained to respond to complaints in an appropriate manner, since dealing with customers is everybody’s job (bonus incentives may help to institutionalize this practice). The following response elements apply to most complaints, whether they are written (a letter of complaint, a complaints/suggestions card) or verbalized:

1. **Gratitude.** Staff must approach complaints in a manner that makes customers feel that their input is appreciated and useful. Thanking the customer for taking the time to provide valuable information is one way to make the customer feel appreciated. It will also help placate a hot temper when the customer is angry because of a mistake on the part of the institution.

2. **Politeness.** The staff member should be kind to the customer, listen attentively to her grievance, and provide encouragement, such as “I understand why you feel this way.” The tone of a written response should have the same degree of politeness and concern. Like the example in Figure 15, written responses that are specific to the problem work the best: Instead of “I am sorry that we were so neglectful,” the letter should say, “I am sorry we overlooked your last loan payment and wrongly charged you interest.” Written letters always address the customer by name.

3. **Admitting the error.** The staff member should never argue with the customer. If the customer has taken the time to come directly to the MFI employee, then the complaint should always be treated as legitimate. Even if the staff member feels the complaint is exaggerated, it is not worth insulting the customer.

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22 Adapted from Barlow and Møller (1996).
4. **A sincere apology.** A sincere apology carries a lot of weight in the eyes of most customers. Sometimes, it is all that the staff member can immediately offer, e.g. in cases where interest was not posted promptly to the balance of a savings account, or when a loan officer was rude to the customer. An apology with a promise to address the problem will satisfy many unhappy customers until the situation is remedied.

5. **A prompt response and resolution.** The staff member should promise the customer that the problem will be resolved as quickly as possible. Complaints with easy solutions, such as posting a corrected loan balance or reprimanding a staff person, should be resolved immediately; more difficult problems, such as disputes with fellow group members, may take longer to resolve. If the complaint is in written form, response letters should be written within three days after the letter was received, and the customer should be given a timeframe within which the complaint will be resolved (see Figure 15).

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**Figure 15: Sample Response to Letter of Complaint**

July 10

Dear Mrs. Jones,

Thank you for your letter dated July 9. I appreciate the time you took to inform us of the difficulties you have faced with retrieving funds from your account, and I apologize for the inconveniences you have experienced.

Other customers have recently complained of inabilities to take out money from their accounts at various times due to incorrect postings of account balances. The problem results from a fault in our computer system that is being repaired by technicians right now. We forecast that the system will be fixed by July 12.

Due to the error, MicroBank will refund you the service charges on your current account for this month as well as next month. Again, I would like to express my sincere apologies and I hope that you will continue to provide us with your valuable patronage.

Sincerely,

Janet Simmons
Customer Relations Manager
MicroBank

6. **Informing other staff members.** For the complaint to be truly resolved, staff members must prevent the problem from happening again. Inform all associated employees that the problem could recur so they can work to prevent it from happening, or so that they may take remedial steps should it occur again. As an added assurance that the problem will be prevented in the future, use the complaint...
7. **Giving back.** Reciprocity is one cornerstone of human interaction. A customer who has been disappointed by the institution is less likely to discontinue patronage if the institution compensates the error. For example, if the customer was accidentally charged late fees, the customer should not only receive a sincere apology and be reimbursed the late fees, but he should receive a package of promotional materials (i.e., t-shirt, calendar, key chain). Exceeding the customer’s expectations is often the best way to encourage forgiveness for errors or mistreatment.

8. **Informing other customers.** Take credit for solving your customers’ problems! This will solicit more complaints and suggestions, and give the MFI extra points for caring about its customers. Some ideas are the following:

- Post a complaint or suggestion of the week on a bulletin board and tell your customers how you responded to it
- Add a customer service column to your newsletter
- Send occasional mailings to all customers saying, *In response to your requests, we are going to undertake the following initiatives...*

**The Eight-step Method for Complaint Resolution**

1. Gratitude to the customer for taking the time to alert staff to the problem
2. Politeness
3. Admitting the mistake (if applicable)
4. A sincere apology
5. A prompt response and resolution
6. Informing other staff members of the problem to avoid future occurrences
7. Possibly giving the client a coupon or gift to encourage future business
8. Informing other customers of the creative ways you have solved various complaints

**How to Interpret and Use Customer Complaints**

Once you have gleaned all this information from your customers, what next? The worst thing that can happen is that the information languishes in a back-office file, never to be used. To avoid this scenario, establish a database to house the findings and a chain-of-command to take action on complaints and suggestions. Figure 16 helps you manage complaints based on the nature of the problem.
Figure 16: Tools to Gather Customer Feedback

<table>
<thead>
<tr>
<th>Tool</th>
<th>Advantages</th>
<th>Disadvantages</th>
<th>What this Tool does Best</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complaint and Suggestion System</td>
<td>Easy to use; cards can be filled out anonymously</td>
<td>Not proactive; not good for illiterate customers</td>
<td>Reminds customers of commitment to customer satisfaction</td>
</tr>
<tr>
<td>Customer Service Desk</td>
<td>Allows for personal attention; good for illiterate customers</td>
<td>May face low volume; customer service representative must have other responsibilities</td>
<td>Gives immediate attention to complaints</td>
</tr>
<tr>
<td>Complaint Solicitation Strategy</td>
<td>Requires little infrastructure; proactively involves loan officers in feedback process</td>
<td>Results may be filtered or biased by loan officers</td>
<td>Gleans information from clients who would not have complained</td>
</tr>
<tr>
<td>Customer Advisory Board</td>
<td>Presents problems from the customers’ point of view</td>
<td>Results may not be representative</td>
<td>Involves customers in process of preventing deflections</td>
</tr>
</tbody>
</table>

Figure 17 depicts the process of using customer complaints and suggestions to your advantage.

**Establish a Customer Feedback Database**

The customer feedback database aggregates data gathered by all four information-gathering methods. Without a formal tabulation of customer feedback, it will be difficult to filter and respond most quickly to the more serious complaints (e.g. fraud or mistreatment), as opposed to more common problems with easier remedies. One staff member should manage input of data. The database includes the following categories:

- Type of feedback (complaint/suggestion)
- Description of complaint
- Date of complaint
- Description of customer (length of relationship with MFI, size of business, type of business, etc)
- Recommended action
- Follow-up procedures

All complaints with similar descriptions should be grouped together. Chapter 7 provides additional suggestions about starting a database.
Figure 17: Interpretation and Use of Customer Feedback Results

Establish a Chain-of-Command to Take Action on Complaints
So far, complaints have traveled from the customer to the staff member to the database. Now it’s time to put those complaints to use. To identify and act upon the most salient problems, it may be useful to have a customer service committee examine the database monthly and suggest appropriate action to management. As mentioned earlier, not all complaints are dealt with in the same manner. For example, if ten customers suggest one month that the branch should be swept more often, it is easy to implement this suggestion. However, if one third of all complaints are associated with the group guarantee scheme, it will be more difficult to implement changes. In fact, doing so would require thorough research and perhaps a complete overhaul of lending activities; this is where the customer service committee comes into play. During monthly or semi-monthly meetings, the committee can address these types of complaints and decide
whether the complaints require further research and perhaps adjustments to the institution’s activities. Management, in turn, can assign the projects to the committee, which will determine the next course of action.

**Improve Customer Service Training**

Customer complaints and suggestions can fuel an effective customer service training module, especially if employee training is a regular activity at your institution. A careful analysis of the database reveals trends that your MFI can seize upon to sensitize staff toward customer likes, dislikes, and needs. If your institution does not already conduct staff trainings, a trial run may prove that regular trainings keep your employees in tune with your institution’s mission, culture, and customer needs. Additionally, it may be helpful to distribute staff memos that highlight areas where customer satisfaction could be improved.

**With the complaint in hand, the institution can work toward satisfying customers and preventing them from defecting.**
Measuring Customer Satisfaction

“Most MFIs operate under the assumption that they have a clear understanding of their customer profiles and needs. Yet when pressed, they find that this understanding is often anecdotal, inaccurate, or obsolete.”

- Monica Brand and Julie Gerschick (2000)

Next in line to preventing defections is satisfying customers you keep. It is important to note that customer satisfaction is a means to an end; the ultimate objective is an improvement in customer loyalty.

The process of measuring customer satisfaction usually involves ongoing mechanisms to monitor customers’ attitudes toward your institution, its products and services. Although it may seem complicated to measure something as subjective and seemingly elusive as satisfaction, it is possible. This chapter contains a set of tools to comprehensively measure customer satisfaction and details how to incorporate the tools into daily operations. This chapter will:

- Introduce five tools to measure customer satisfaction and solicit feedback
- Examine the advantages and disadvantages of implementing these tools
- Provide guidance in interpreting the results of customer satisfaction studies

Part of measuring customer satisfaction entails finding out what customers like and what they wish they could change about the institution, what they find convenient and inconvenient, and why they might drop out. Once satisfaction is measured, it can be managed. Measuring and managing customer satisfaction involves the following four steps:

1. Measure customer retention on an ongoing basis for a general understanding of customer satisfaction.
2. Continuously measure customer satisfaction and determine customer preferences.
3. Once customer preferences are revealed, determine whether changes are needed.
4. Implement changes if necessary and encourage customers to remain or to return.

Tools to Measure Customer Satisfaction

This chapter details five ways to gather customer feedback that will help your institution reduce desertion and keep customers happy. Questions on loan applications and customer satisfaction surveys provide an ongoing, active illustration of customer satisfaction; targeted customer surveys supply valuable information on customer
preferences; focus groups help brainstorm ideas and find solutions when there is a dip in customer satisfaction; and mystery shopping evaluates the quality of the customer service. This chapter explains how to use these tools, as well as the pros and cons of each. To prevent an overload of information, the more technical aspects of the tools are saved for Chapter 7. Figure 18 provides an overview of the tools in this chapter.

<table>
<thead>
<tr>
<th>Tool</th>
<th>Relative Cost</th>
<th>In-House or Third Party?</th>
<th>Overall Effectiveness</th>
<th>Frequency of Use</th>
<th>For what size institution?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus Groups</td>
<td>Medium</td>
<td>Either</td>
<td>Medium to High</td>
<td>As Needed</td>
<td>All</td>
</tr>
<tr>
<td>Satisfaction Surveys</td>
<td>High</td>
<td>Third Party</td>
<td>Medium</td>
<td>As Needed</td>
<td>Medium to Large</td>
</tr>
<tr>
<td>Targeted Customer Surveys</td>
<td>High</td>
<td>Third Party</td>
<td>High</td>
<td>As Needed</td>
<td>Medium to Large</td>
</tr>
<tr>
<td>Mystery Shopping</td>
<td>Medium to High</td>
<td>Third Party</td>
<td>Medium</td>
<td>As Needed</td>
<td>Large</td>
</tr>
<tr>
<td>Questions on Loan</td>
<td>Low to Medium</td>
<td>In-House</td>
<td>Medium to High</td>
<td>Always</td>
<td>All Sizes</td>
</tr>
<tr>
<td>Applications</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Tool #1: Questions on Loan Applications**

To systematically monitor the sentiment among your existing customer base, it is possible to include questions on loan applications to track a customer’s relationship with an MFI over time. These questions evaluate the customer’s initial expectations of the MFI and then, if they return for a repeat loan, whether these expectations are met and what their new expectations are. Questions on the first application might ask about expectations and past experiences, and questions on subsequent applications might ask about the customer’s progress and later concerns. This differentiation is important because people’s needs and expectations evolve over time. Questions tend to be brief, require just a few minutes of the customer’s time, and have the following goals:

- To discover why customers selected your MFI
- To determine what customers want to gain from their relationship with you
- To establish their level of satisfaction with your products and services

From responses, the institution might discern a pattern of how customers hear about the organization and focus advertising efforts based on the results. When the MFI knows what customers wish to gain and what their preferences are, it can figure out how to best serve its customers.

When the MFI knows what customers wish to gain and what their preferences are, it can figure out how to best serve its customers.
If a new customer has recently left another institution, questions on loan applications can also act as a shrewd way to conduct someone else’s exit interview: you can find out why the customer left the previous MFI and other information about the competition.

**Advantages.** This method of measuring customer satisfaction has the benefit of giving customers a feeling of collaboration with the institution from the beginning of the relationship. And because it is not time-consuming, this method can be used consistently to catalog customer preferences. In a competitive environment, the MFI can get a sense of why people choose one institution over another, rather than learning the hard way, when the customer deserts, or worse, defects. With information about customer expectations, the institution gets the chance to meet and exceed those expectations.

**Disadvantages.** The loan application process may bias the results. Since customers are requesting loans, they may not want to jeopardize their relationships with loan officers by giving a negative account of experiences, or by stating needs that may give the loan officer the impression that the customer is high maintenance or will be a difficult customer. Also, many MFIs wish to attain greater efficiency by streamlining the application process, and adding loan application questions may hinder that effort.

**How to Interpret and Use Results and Findings.** Whereas one customer’s expectations are of minor significance, trends in customer expectations can be tracked and highlighted when they are aggregated in a database. Unfulfilled expectations should be considered in efforts to increase customer satisfaction. The expectations of customers who later drop out can also be analyzed to achieve the same effect: highlighting those unmet expectations that may have caused the customer to leave. The gap between what is expected to happen and what actually happens is often the source of customer desertion.

**Tips and Suggestions.** How tailored the questions are to each customer varies according to the institution’s size and capabilities. The second and third follow-up applications may have tailored questions while later applications may not, or every third loan application may have customized questions. Alternatively, tailored questions may be too time-consuming for the institution to undertake at all, and loan application questions may simply ask general questions.

If the MFI conducts an exit interview at the close of each loan, it need not ask additional questions on the loan application. Customers do not want to be bothered with excessive question-and-answer sessions.
Regular monitoring of customer satisfaction is an important component of an early warning system that can raise red flags for managers and directors that problems are pending. The system is only effective if the following conditions are met: 1) surveys are conducted at regular intervals with a random sample of customers; and 2) a similar survey instrument is used each time.

As shown in Figure 20, satisfaction surveys typically ask customers to rate different aspects of the organization’s products and services on a scale of 1 to 5, with 5 being very satisfied and 1 being very dissatisfied. Determining how important each of the variables is to the customer then strengthens this information. The column “How Important to You?” helps the MFI to understand customer priorities.

Advantages. Besides being a valuable warning indicator, satisfaction surveys are an important complement to loyalty monitoring. People who are satisfied may not actually be loyal and vice versa. Customer satisfaction surveys can identify pockets
of false loyalty: customers who aren’t satisfied, but remain loyal because they don’t have any other choice or because they’ve decided that the disincentives for defection are too high. For example, if they went to the competition, maybe they would have to start at the entry-level loan size; so even though they are unhappy with your service, they believe that they can’t afford to leave. But when a better deal emerges, these customers will be the first to defect.

**Figure 20: Sample Customer Satisfaction Survey**

<table>
<thead>
<tr>
<th>How Satisfied?</th>
<th>How Important to You?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Very unsatisfied</td>
<td>1. Very unimportant</td>
</tr>
<tr>
<td>2. Somewhat unsatisfied</td>
<td>2. Unimportant</td>
</tr>
<tr>
<td>4. Satisfied</td>
<td>4. Important</td>
</tr>
<tr>
<td>5. Very satisfied</td>
<td>5. Very important</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Product Design</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Loan size</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>2. Loan term</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>3. Interest rate</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>4. Administration fee</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>5. Repayment frequency</td>
<td>1 2 3 4 5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Customer Service</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Quick loan application process</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>7. Friendliness of loan officer</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>8. Loan officer understands my needs</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>9. Other branch staff were courteous</td>
<td>1 2 3 4 5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Office Environment</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Hours of operation</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>11. Facilities are clean</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>12. Convenient location</td>
<td>1 2 3 4 5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>General</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>13. My overall level of satisfaction with MicroBank is:</td>
<td></td>
</tr>
<tr>
<td>- Strongly dissatisfied</td>
<td>- Dissatisfied</td>
</tr>
<tr>
<td>14. I plan to use MicroBank’s services again in the future:</td>
<td></td>
</tr>
<tr>
<td>- Strongly disagree</td>
<td>- Disagree</td>
</tr>
<tr>
<td>15. I will recommend MicroBank’s services to others:</td>
<td></td>
</tr>
<tr>
<td>- Strongly disagree</td>
<td>- Disagree</td>
</tr>
<tr>
<td>16. My satisfaction would improve if MicroBank made the following changes:</td>
<td></td>
</tr>
</tbody>
</table>

**Disadvantages.** This type of survey with ranked responses can only provide superficial information about how customers generally feel about the MFI. It can be expensive to conduct satisfaction surveys since they have to be done regularly for the results to be useful. This tool is most appropriate for larger organizations, particularly those that operate in a competitive environment. It cannot be effectively
implemented by branch staff who might have an incentive to bias the results, so it either needs to be implemented by a third party or head office staff.

**Interpreting the Results.** There are two primary ways of interpreting the results. The first is to monitor satisfaction trends over time to ensure that customers’ enthusiasm isn’t waning. The second is to compare satisfaction results between branches and create a prize for the office with the most satisfied customers.

**Variations.** The costs of conducting satisfaction surveys can be substantially reduced if they are implemented by telephone or by mail, but the response rate is likely to suffer as well. MFIs could include these types of satisfaction monitoring questions into an end-of-loan or exit interview conducted with all customers when they make their final repayment.

To consolidate costs, Caja Los Andes uses internal audit customer visits to ask about the quality of attention that Caja Los Andes provides, and asks for any suggestions the customer might have. The staff member then asks a few questions about the customer’s revenue and expenses, and finally asks for additional observations and comments. All comments are recorded on the internal audit report sheet.

**Tool #3: Targeted Customer Surveys**

In contrast to satisfaction surveys, targeted surveys are conducted on an occasional basis to explore opportunities or problems in greater depth. For example, an MFI might decide it needs to conduct a targeted survey if satisfaction or retention numbers start to slide so it can learn what lies beneath the burgeoning discontent. A targeted survey is also an important tool in designing new products and determining the potential market among your existing customer base.

**Findings from CERUDEB’s Customer Survey**

After the most recent customer survey at CERUDEB, the results led to the following changes at the bank:

- Since many women are unable to meet the collateral requirements of receiving a loan, and since they also receive a greater positive impact from receiving a loan, Centenary will explore modifications for evaluating women’s eligibility for loans.
- Management will ensure that policies and procedures (e.g. concerning minimum requirements for loan eligibility) are applied identically at the head office and branches. Branches often interpret policies more strictly than intended.
- Because further computerization would quicken the loan process and provide the head office with more extensive and current records, Centenary will explore options to develop a computer networking system for all branches.

**Variations.** Staff can conduct targeted surveys so that they seem more informal (and less intimidating) by turning them into a brief conversation included in regularly-scheduled follow-up visits (as conducted by ABA), a few questions piggy-backed on internal audit visits (as Mibanco does), or a short dialogue that branch staff have with customers making their weekly or monthly visits to the branch.
Measuring Customer Satisfaction

Based on experiences with conducting customer surveys, CERUDEB offers the following suggestions:

- The team that carries out the survey should have the following skills: field experience, financial institution expertise, field and statistical methodology expertise, computer skills, and local knowledge (including languages).
- Planning, scheduling, and booking transport may be necessary to administer surveys in remote areas.
- The survey should be clear and not too long, but comprehensive.
- Accurate translation of the survey into local languages is essential.
- It is necessary to have enough reproductions of the survey on hand at all times.
- It is helpful to choose alternates for individuals who end up being unavailable to complete the survey.
- Extensive training is required to ensure that survey administrators understand the meaning of all questions and how to record answers.
- A field pre-test of the questionnaire usually reveals problematic questions; often the survey must be revised. The pre-test ensures that the survey asks the right questions in a clear manner.
- Data entry should begin as soon as possible. If the people who conduct interviews also input data, they are able to check data for accuracy during the process. On average, it took Centenary team members 15 minutes to input data from a 30 minute survey.
- Data analysis should be conducted systematically. It is useful to first explore “descriptives” (averages, frequency counts) for all variables, and then to disaggregate the numbers (i.e. according to gender, location, occupation, etc).
- Because the bank administered its survey in regions where various languages were spoken, administrators took care to ensure that the surveys were translated correctly. First, one person translated the survey from English (the survey’s original language) to the local language. Then, another person translated it back into English. Where the translators found discrepancies between the back-translated document and the original, there were obvious flaws in the translation.

Examples. Centenary Rural Development Bank hired a consultant to administer a customer survey in March 1999. The survey was done branch by branch, and results were shared with employees. Although results were largely positive, the bank adopted the attitude that services could be improved nonetheless. In the “comments and suggestions” section of the survey, customers pointed out shortcomings of branches in one particular region, such as some staff did not speak the local languages, and some staff members were not friendly to customers. In response to these findings, CERUDEB made staff changes to mitigate the problems.
Tips and Suggestions. Survey questions should be read by several employees to determine that the questions are straightforward and pertinent to the study’s objectives. Then, the surveys should be pre-tested with a small sample of customers.

An interesting question should open the survey, and more personal questions should be saved for the end. This approach makes the survey seem friendlier to the customer, and is less likely to discourage him or her from answering all questions.

As a courtesy, especially for surveys that take more than ten to 15 minutes to complete, MFIs can offer compensation or small tokens of appreciation, like a pen or a calendar, but should beware of negative repercussions of what some customers might consider a bribe.

During interviews, administrators should encourage the customer to speak freely, and assure the customer she will not be judged based on how she replies.

Surveys can also be used prior to offering new products to test customer interest in expanded services. K-Rep in Kenya administered a survey in 1998 to determine whether customers would be interested in opening up a savings account with K-Rep Bank. The survey also asked about how much and how often customers would deposit. With this information, K-Rep was able to foresee the type of activity that would take place in future accounts, influencing both product design and business planning. Armed with this information, they were able to create a savings program that was tailored to customer preferences.

Advantages. Targeted surveys can go into greater depth than satisfaction surveys. Instead of just asking if the customer would recommend you to others, you can find out why they would recommend you to others and why they would not recommend you.

It is often advantageous to carry out targeted surveys as interviews rather than the more formal written version. Whereas written surveys can be intimidating, a friendly chat with a loan officer or other staff member may be less so, and can still garner the same information. Interviews are also appropriate for illiterate customers. This type of survey can strengthen relationships between staff members and customers. For newer customers who may not yet have a full understanding of institutional procedures, these conversations can be a time for them to seek help from the staff, which alerts the institution to problems customers may be experiencing and gives customers a sense that the institution is looking out for their interests.

Another variation is to have a third party carry out the interviewing process. The advantage of implementation by a third party is that it could add a layer of objectivity to the analysis. Customers are sometimes hesitant to voice their true feelings to loan officers or familiar staff.

Disadvantages. To obtain statistically significant results, the institution must spend considerable time, energy, and money, often using outside consultants to help administer the survey and analyze the results.
Measuring Customer Satisfaction

Tips and Suggestions. Bandesarrollo telephones focus group participants five times during the two-week period leading up to the event to remind them to attend. As a courtesy, Bandesarrollo pays for their transportation.

The AIMS “Learning from Customers” focus group tool suggests that the moderator open the session by making introductions around the group. Then, he or she should explain that the purpose of the session is to seek the advice of participants, who will serve as advisers to the organization and share their knowledge based on personal experience. The customers act as an advisory board that designs a program to satisfy the demands of as many customers as possible, and the moderator asks questions to fine-tune that program.

Interpreting the Results. Answers to closed-ended questions must be entered into a database; these will be the easiest to interpret. Answers to open-ended questions must also be entered into a database, but organizing and interpreting these results may prove to be more difficult. Staff should group and tally similar answers to make interpretations easier. For more detailed information on analysis of results, see Chapter 7.

Tool #4: Focus Groups

A focus group is an information gathering technique that allows customers to influence the future of the institution by sharing their opinions and offering solutions to satisfaction issues. The moderator who facilitates the session should have some degree of training and preparation for this role as well as an outgoing personality. If the moderator is part of the MFI’s staff, she is typically not personally invested in the subject at hand. For example, the branch manager usually should not moderate a focus group that discusses branch-level customer service.

Focus groups are usually small, often six to 12 participants, and last about an hour. Participants should proportionately reflect different segments of the MFI’s customer base. At the same time, the participants’ needs should be related to the topic, i.e. only customers who have (or who are interested in having) current accounts should be included in a focus group that addresses that topic. More specific suggestions about running focus groups are provided in the following chapter.

Example. Every six months, FINCA Kyrgyzstan holds a focus group meeting where customers are asked to do some problem-solving for the institution. Loan officers choose 20 to 30 participants from different regions, economic groups, and with various levels of microfinance experience. Four such meetings are held in different regions of the country. FINCA reports that when customers are invited to attend, they consider it an honor and need no other incentive to participate.

Compartamos also holds regular focus group meetings. In addition to involving current customers, Compartamos invites past customers and non-customers to discuss general problems, needs, and expectations of microentrepreneurs.

Advantages. Focus groups are especially suitable for MFIs because they are inexpensive to administer, provide a participatory alternative for uneducated customers who may not feel comfortable responding to a survey, and allow customers


to feel included in the decision-making processes of the institution. These sessions provide opportunities for customers to discuss and debate issues and feed off each others’ ideas, which can produce a greater depth of analysis than individual interviews can.

**Disadvantages.** Because of their small size, the MFI must run several focus group sessions to ensure that the results are reasonably representative. Focus groups require significant planning, and results are difficult to predict. Confirmed participants may not show up, or those who do show up may be reticent. Special efforts must be made to ensure the attendance of participants and lead the group through a fruitful discussion.

**Interpreting the Results.** It is helpful to have an assistant who takes copious notes during the discussion and/or otherwise records them (audio or visual). Video cameras can also be used to record the event, but participants may consider them obtrusive. The taping or observance will result in a written transcript of the session and a written report, and a team will analyze the transcript and determine next steps. More detailed information about analyzing focus group results is provided in Chapter 7.

**Tool #5: Mystery Shopping**
A “mystery shopper” is an individual contracted by the institution to pose as a customer in order to evaluate the quality of the organization’s customer service. The shopper, who is essentially management’s spy, completes a standard report on services she received in each branch. To enhance the value of the information she receives, she might pose a complaint to evaluate the response she receives or ask for non-standard terms and conditions on products. Management uses the report to identify strengths and weaknesses of the institution’s customer service and to make adjustments as necessary. Figure 21 provides a sample report form.

To test the viability of such a program in your institution, run a pilot test with three to five “shoppers” and examine the results. The “shoppers” should be given a list of services to request and questions to ask, as well as a written form to describe the experience. When he is finished with the task, the “shopper” can say that he’ll think about it, and that he’ll come back. If the pilot test runs smoothly and produces useful results, the study can be replicated.

**Variations.** Another way to go about “mystery shopping” is to have a manager from another branch play the role of the shopper, either in person or by telephone, which is the approach used by Banco del Desarrollo. Still another variation is to have the mystery shopper visit a competitor and compare the two institutions. With this information, the MFI can make the necessary improvements to provide the best possible microfinance services.

**Advantages.** Mystery shopping details an individual’s experience with the institution and can pinpoint flaws in employee work habits that negatively affect the customer. Specific operations can be examined: the mystery shopper knows what to look for and knows whether or not protocol was followed. And, if staff members know about
the possibility of being evaluated by a mystery shopper, they will always be on their toes.

**Figure 21: Sample Mystery Shopping Form**

Please complete this form immediately following the branch visit.

1. How long did you have to wait for service?
2. If you waited in line for more than ten minutes, or if there was any other inconvenience in the branch, did the staff person apologize in a sincere way?
3. Was the staff member otherwise polite?
4. Did the staff member follow procedures?
5. Did the staff member suggest appropriate loan products for your specific needs?
6. Were explanations clear and accurate?
7. Did the staff member offer useful services?
8. Did the staff member ask for appropriate information for the loan application?
9. Were you charged any fees? If so, for what?
10. Please comment on the appearance of branch and personnel.

**Disadvantages.** Hiring a professional may be costly to the institution. Professional mystery shoppers are hard to come by in many countries, and when they are available, they may have a different perspective on microfinance than actual customers, which may skew the results. Also, the professional is often limited to evaluating the loan application process or the process of opening a savings account. He cannot evaluate follow-up procedures, loan repayment, or how the branch deals with complaints, since the “mystery shopping” process necessarily would end before the loan would be disbursed. It is also more difficult to use this tool in a group lending methodology, and may not work very well in smaller communities, where everyone knows everyone else.

**Tips and Suggestions.** Before conducting the investigation, the mystery shopper should be trained to know what to look for, i.e. courteousness of staff, knowledge of staff, and adherence to specific procedures.
Interpreting the Results. The shopper should report to management following each branch visit. In the case of negative reports, management should go directly to the source and determine if the problem is endemic or short-term, and encourage branch workers to improve operations or else suffer consequences.

Summary of Tools

Although measuring and improving customer satisfaction is time-consuming and costly in the short run, it is an important component of a customer loyalty strategy. Only by measuring satisfaction is it possible to manage it.

Figure 22 provides a summary of customer satisfaction measurement tools that we have discussed in this chapter. When choosing which tools to use, you should take into account the size and culture of your institution, the nature of the clientele, and your infrastructure and budget considerations. For example, an institution that relies heavily on the loan officers’ relationships with customers can gain substantial information from questions on loan applications, whereas a large commercial MFI may have to rely on surveys to gather similar information. The MFI should rely on a mix of measurement tools that is appropriate for its specific needs.

<table>
<thead>
<tr>
<th>Tool</th>
<th>Advantages</th>
<th>Disadvantages</th>
<th>What This Tool Does Best</th>
</tr>
</thead>
<tbody>
<tr>
<td>Questions on Loan Applications</td>
<td>Easy to administer, targets most if not all customers</td>
<td>May be biased; customers may perceive as a hassle</td>
<td>Gathers data on customer expectations</td>
</tr>
<tr>
<td>Satisfaction Surveys</td>
<td>Systematically monitors customer sentiment</td>
<td>Must be conducted regularly; only collects superficial information</td>
<td>Provides an early warning sign of potential problems</td>
</tr>
<tr>
<td>Targeted Surveys</td>
<td>Provides an opportunity to probe problem areas in detail; can be conducted formally and informally</td>
<td>Requires a significant investment in planning, preparation and analysis; may require external support</td>
<td>Gleans specific information from a scientific sample of customers to improve products/services or for developing new products</td>
</tr>
<tr>
<td>Focus Groups</td>
<td>Increases feeling of empowerment in customers; allows for detailed discussion of customers’ opinions</td>
<td>Not statistically significant</td>
<td>Allows customers to contribute ideas to improve institution</td>
</tr>
<tr>
<td>Mystery Shopping</td>
<td>Evaluates specific areas of customer service</td>
<td>Can be hit or miss; only reveals problems specific to certain branches or staff members</td>
<td>Highlights strengths and weaknesses of customer services</td>
</tr>
</tbody>
</table>

Management should always have some idea of the level of customer satisfaction in the institution. Ongoing tools, such as satisfaction surveys, provide a general picture of
customer satisfaction. They identify who’s happy, who’s not, and why. Examining how well the institution serves its customers is of utmost relevance to customer satisfaction—and therefore customer loyalty—and should thus be a serious undertaking. Once you have a good idea of the levels of customer satisfaction and customer service in your institution, it’s time to conduct a targeted survey or ask customers to attend focus group sessions to figure out what to do next.

Among the members of the MicroFinance Network, institutions have either conducted extensive customer satisfaction research or none at all. This finding suggests that once an institution does some customer satisfaction research, it usually becomes committed to the idea and creates an entire regimen.
The design of the quantitative tools in the customer loyalty management system requires a foundation of technical knowledge. This chapter is a resource of technical guidance for the construction and implementation of the customer loyalty management system. It will provide advice about:

- Designing surveys
- Conducting focus group sessions
- Sampling a representative group of customers to conduct studies
- Discovering procedural errors and understanding their consequences
- Analyzing results

This chapter provides practical, easy-to-use instructions for the more technical aspects of creating a loyalty system. You will notice that many of the tools that we have discussed in earlier chapters don’t appear here; those tools are relatively easy to design and implement. Here we tackle some of the tougher issues.

**Surveys**

Survey composition and administration is a task that requires considerable planning, foresight, attention to detail, and patience. It is a technically demanding pursuit, and if the institution is to conduct the survey internally, there is a great variety of details with which to become familiar before attempting the feat. There is the timeline and the budget, which must be proposed and approved before the survey takes place in order to establish cost feasibility and availability of staff time and resources; there’s the survey team, which must be gathered and trained; and then the team must write the survey, field test the survey, and administer it. On top of that, the survey team must analyze results. This section will acquaint potential survey administrators with the finer points of conducting a survey, and will also suggest further reading for more ideas.

**Survey Design**

Survey design requires several equally-important elements, including definite objectives, proper question order, appropriate types of questions, and knowledge of customer characteristics and requirements.
To develop an effective survey, the survey team must first establish **objectives** and specify the information that it hopes to glean from customers. It is important that the survey have an explicit focus from the outset to avoid asking unnecessary questions and wasting both the time of the customers and of the survey administrators. Some examples of survey objectives are as follows:

- To find out if customers are satisfied with the attitude and service of staff
- To determine whether loan terms, amounts, and turn-around times are suitable for customers
- To learn whether a new savings or loan product is being received well by customers
- To establish whether branch locations and hours are convenient

Surveys can touch on a few issues, but the bulk of the questions should address only two to three topics. Objectives usually result from trends observed in other customer satisfaction measurements, such as the complaint database or loan application questions. Since each survey requires a significant financial investment, administrators should not be eager to accomplish too many objectives; it is better value for the money to conduct an in-depth study into a few areas than a superficial study into many areas. Although it is tempting to follow the logic that since it is so expensive, you had better learn everything you can, the results obtained from such a survey will lack the depth necessary to understand and improve customer loyalty.

After the objectives have been established, the information the survey hopes to retrieve must be specified. There are four steps to creating a survey: (1) knowing customer characteristics (who customers are), (2) making assumptions about customer requirements (what customers need), (3) writing the survey in an objective, straightforward manner, and (4) field testing the survey and making changes based on results.

The most important concern about a survey is that it asks the right questions, which requires knowledge of customer characteristics. Based on customer characteristics, each MFI must make certain assumptions about customer requirements to help ask the right questions about services.

The following is an example of an MFI’s customer characteristics:

<table>
<thead>
<tr>
<th>Is My Institution Prepared to Administer a Survey?</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Do I have enough available funds to conduct a survey? (Create a budget.)</td>
</tr>
<tr>
<td>• If so, do I have qualified staff members who are available to administer the survey? (Build a team, train the team.)</td>
</tr>
<tr>
<td>• If necessary, is it possible to outsource the project? (Determine required funds for salaries, per diem, transportation, etc.)</td>
</tr>
<tr>
<td>• Do I have a functioning database that can handle the project?</td>
</tr>
<tr>
<td>• Do I have the capacity to analyze the survey and propose changes?</td>
</tr>
<tr>
<td>• Is my institution willing to change procedures and products to accommodate customer preferences?</td>
</tr>
</tbody>
</table>
Most customers…

1. Use their loans to produce items for sale at local markets.
2. Spend their mornings selling at local markets.
3. Are women with several young children.
4. Live five to ten miles away from their nearest branch.
5. Own bicycles.

From this set of characteristics, the MFI can make assumptions about its customers’ requirements, such as the following:

1. Customers can get to branches relatively easily, but because of market hours and child care needs, they do not have much time to spend there. Therefore, they need expedient service.
2. Most customers will not use services during the morning and require other daytime hours.
3. Depending on their business, customers may need flexible loan terms and amounts.

Customers, either through informal meetings or focus groups, should agree upon these assumptions. When customer requirements have been hypothesized, the job of the survey is to test the hypotheses, determine whether customer requirements are being met, and understand levels of customer satisfaction as they relate to the chosen topics.

**Creating a Successful and Effective Survey**

There are several types of surveys, each championed by different research experts. One characteristic all surveys have in common is that they should be succinct and to the point; a survey that requires 20 to 30 minutes of the customer’s time is sufficiently long. Other suggestions for a successful survey are as follows:

**Order of questions.** The survey should open with an interesting question that will draw the customer in. Personal questions, such as ones that pertain to monthly income or business expenses, may make the customer uncomfortable and should be saved for last. Some survey experts recommend that the most important question be asked near the beginning or middle of the survey. Otherwise, if the most important question is asked near the end, then customers will naturally think back on answers to

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**Survey Budget Considerations**

- Training the survey team
- Designing the survey
- Field testing the survey
- Survey translation
- Copying the survey
- Transportation to and from customer homes
- Database entry
- Survey analysis
specific, closed-end\(^{23}\) questions from the beginning of the survey and choose an answer based on those issues (assuming the “most important” question is open-ended\(^{24}\)).\(^{25}\)

Types of questions. Knowing what types of questions to ask is the second component of creating a successful survey. There are many ways that question types and the manner in which questions are asked can bias participants’ responses to the survey. The following advice can minimize bias.

- **Don’t ask leading questions.** A leading question has the answer imbedded within, such as “Do you usually wait in line for a long time at the branch?” The question itself suggests that lines are long, and directs the customer to answer that they are. This question is more appropriately phrased as, “On average, how long do you usually wait in line at the branch?” Leading questions will not result in true answers. If the survey is conducted as an interview, be sure that staff don’t ask questions with voice intonations that lead customers to certain answers. Also, explain to interviewers why it is important to ask the question exactly as it appears on the form.

- **Avoid “double-barreled” questions.** A double-barreled question asks two questions at once. For example, “Do you favor increasing loan sizes by raising the minimum savings requirement?” If the respondent says no, it is unclear whether she doesn’t want to increase loan sizes at all, or doesn’t want to increase loan sizes if it is linked to raising the minimum savings requirement.

- **Include open-ended questions.** Open-ended questions allow the customers to bring up issues related to the topic that the survey administrators could not have foreseen or did not think of. They provide room for a more well-rounded body of responses from the customers. Open-ended questions should be asked before closed-ended questions to avoid limiting responses.

- **Vary question type.** Avoid a series of “yes/no” questions where “yes” generally signifies positive feelings and “no” generally signifies negative feelings. Often, an acquiescent person who is generally satisfied will reply “yes” all the way down the line without seriously considering any of the questions.

Figure 23 represents a sample survey based on customer requirements outlined earlier. This survey addresses satisfaction with the customer’s current loan product and service at the branch.

Figure 24 provides a different approach, which takes into account both customer expectations related to a service and the value of that service in the mind of the customer. This type of survey gives institutions an understanding about what aspects of service are most valuable to customers, and whether or not the institution is meeting customer needs. When customers feel that their expectations are not met on items of high importance, the institution should focus on improving those items.

\(^{23}\) A closed-end question is one with a fixed set of answers, such as a multiple-choice question.

\(^{24}\) An open-ended question is one where the respondent can write in his own response.

Figure 23: Sample Survey 1

In an effort to learn how to serve you better, we ask that you fill out this short survey. Please circle the letter that corresponds most closely to your personal opinion.

Age:
Gender: Male___ Female___
Type of Business:

1. What is the best part about being a member of this institution?
2. What would you like to see change about the institution?
3. How many years ago did you join?
4. What was your last loan size?
5. For what purpose did you use the last loan?
6. Loan amounts
7. Loan terms
8. Amount of time you wait in line before receiving service at the branch
9. Branch hours

Figure 24: Sample Survey 2

Please circle the number that best corresponds to your opinion.

<table>
<thead>
<tr>
<th>Expectations</th>
<th>Services</th>
<th>Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not met</td>
<td>Loan terms</td>
<td>Low</td>
</tr>
<tr>
<td>1 2 3 4</td>
<td>Interest rate</td>
<td>1 2 3 4</td>
</tr>
<tr>
<td>1 2 3 4</td>
<td>Branch hours</td>
<td>1 2 3 4</td>
</tr>
<tr>
<td>1 2 3 4</td>
<td>Branch location</td>
<td>1 2 3 4</td>
</tr>
<tr>
<td>1 2 3 4</td>
<td>Attitude and availability of staff</td>
<td>1 2 3 4</td>
</tr>
<tr>
<td>1 2 3 4</td>
<td>Time spent per week conducting bank business</td>
<td>1 2 3 4</td>
</tr>
</tbody>
</table>

Adapted from Barsky
The survey in Figure 25 also takes two parameters into account: use of a service and satisfaction with the MFI’s provision of that service. If your customers use a given service at another bank and are highly satisfied, then your institution should find ways to increase the quality of your own service.

**Figure 25: Satisfaction and Use of Services**

<table>
<thead>
<tr>
<th>Type of Service</th>
<th>Use of Service</th>
<th>Satisfaction with Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Don’t Use</td>
<td>Use at another institution</td>
</tr>
<tr>
<td>Passbook Savings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wire Transfer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Housing Loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parallel Credit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pawn Loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer Loans</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Thank you for taking the time to fill out this survey.*
*Please rate these services according to the categories that follow.*
*If you use the service both at MicroBank and another bank, you may check two boxes in the first column.*

**Field Testing**

Even the most carefully-constructed surveys are vulnerable to being misunderstood by customers or having other shortcomings. For this reason, survey questions (as well as questions on loan applications and the subjects of mystery shopping assignments) should be field tested (i.e. pre-tested).

To field test surveys, a representative sample of approximately 25 customers complete the survey. Administrators time them to estimate how long the survey will take to complete. When customers have finished, they report to survey administrators about which questions they considered confusing, unclear, or otherwise problematic. One
common problem is when a respondent gives irrelevant information, e.g. you asked about a recently-altered loan product, and instead of talking about the benefits of the “new” product, the respondent talks about the “old” product. In this case, the question should be clarified. Administrators take note of all problems and fine-tune the survey. Field testing questions on loan applications can be treated much the same, though the timing element is of less importance.

**Survey Administration**

The administration team is as important to the success of the survey as the customers who will complete it. The team must know the survey well and be intimately familiar with the questions, which will take some time and training. Field testing the survey will be helpful to this training; it will give administrators an indication of what kinds of questions customers might ask and prepare them to give answers.

Once the sample of participants is chosen, institutions should find out the chosen customers’ availability and willingness to fill out the survey. The institution may choose to have all customers visit branch offices at the same time to complete the survey, it may choose to visit customers’ homes to administer the survey, or it may choose to mail the survey to customers. One problem with mailing surveys is that mail gets lost (both en route and once arrived) and that customers may be reluctant or too busy to remember to fill them out. The reluctance could necessitate visits or phone calls from survey administrators, so it might save the institution time and money to be present while the customer fills out the survey to begin with.

The best way to administer the survey is for the staff to read the questions to customers so that when a customer does not respond fully, the administrator can probe him for more details. Reading the questions (i.e. conducting the survey like an interview) also helps to ensure that customers understand the questions and that illiterate customers can fully participate. The reading should be done in the most neutral manner possible to avoid leading customers to more favorable answers.

**Planning a Focus Group**

With refreshments, a comfortable setting, and an enthusiastic moderator, focus groups can elicit a wealth of important customer information. This tool is ideal for testing an idea for a product, to understand sources of customer dissatisfaction, or to generate customer suggestions for changes in operations. Some institutions hold several focus groups on the same topics until it is exhausted and customers generate no new ideas on the subject.

In microfinance, some information obtained from a focus group meeting may be even more accurate than information obtained from a survey, because participants in the group likely know each other and will check each other’s honesty of response. If participants
do respond inaccurately, it is probable that other participants will call out and correct them.  

**How to Choose the Topic**

The topic takes into consideration customer characteristics and requirements, as discussed in **Surveys**. Often, loan officers or other frontline staff have an idea of the issues that are important to customers and can suggest an appropriate topic or confirm the suitability of a proposal. Customers can also help choose the topic. Compartamos determines the focus group topic by inviting several customers to a preliminary “guideline” meeting. A facilitator runs the meeting and guides the customers into choosing important topics.

Another way to have customers choose the topic is by presenting a very broad question to them and letting them narrow down the scope of the question. For example, the topic can be “factors that influence customer satisfaction at MFIs,” and then the group can brainstorm a list of all possible topics under that theme. Eventually, the group should narrow the topics down to a list of 3 or 4 (either by crossing some out or by ranking them all), and those topics will be the ones explored during the focus group session. Figure 26 illustrates this example.

**Figure 26: Choosing a Focus Group Topic**

---

<table>
<thead>
<tr>
<th>Factors That Influence Customer Satisfaction:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Flexibility</strong></td>
</tr>
<tr>
<td><strong>Attentiveness</strong></td>
</tr>
<tr>
<td>Turn-around time</td>
</tr>
</tbody>
</table>

**Necessary Objects for a Successful Focus Group**

- A quiet room to hold the session
- Large paper or a blackboard to document suggestions, writing instruments
- A recording device (audio or video)
- An administrative team: moderator, observer, and analyst
- Refreshments
- Participant name cards
- Focus group coordinator to choose participants and ensure their arrival

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**How to Choose Participants and Ensure Their Arrival**

Institutions select focus group participants in a range of ways. Most do not choose them completely at random, but allow loan officers and other front-line staff to choose

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customers of various backgrounds. FINCA Kyrgyzstan’s credit officers choose customers from different regions, different parts of the loan cycle, and of different experiences. Each time there is another focus group meeting, the composition of the group changes.

Other institutions choose participants based on random sampling according to market segments (i.e. a proportionate number of customers from each segment). In this case, it is useful to informally interview the prospective participant prior to the focus group meeting; if the customer is introverted, it is unlikely that he will contribute meaningfully to the group discussion. During this process, there is no need to tell customers that they are being screened for a focus group meeting; the conversation can be approached as an informal inquiry about customer satisfaction. One way to screen potential participants is by asking them a couple of questions about their loan use; if the customer responds with very short answers, it is unlikely that the customer will add to an in-depth and lively discussion. The cost of this process is outweighed by the assurance that the focus group will be fruitful and productive.

Once participants are chosen, the institution must confirm their interest in participation. Market researchers commonly believe that there will be at least a 20 percent attrition rate of confirmed participants; if ten people say they will attend, it is likely that only eight will. Banco del Desarrollo reports more extreme results: to have six people show up to a focus group meeting, the confirmation of 30 is necessary. In contrast, FINCA Kyrgyzstan says that any customer who is asked to participate feels honored and will do so willingly. The institution must take into account the character of its borrowers and cultural norms before deciding the best way to get the desired number of customers.

Setting Up the Discussion

Before the group starts, there should be a welcome session where participants can meet and talk informally. During this pre-discussion phase, the moderator (and assistants) mentally divides the group according to who is domineering and who is shy. Then they seat the customers accordingly: domineering customers next to the moderator (in case they need a gentle nudge to be quiet), and shy customers across from the moderator (in case the moderator needs to establish eye contact to bring them out).27

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Seating arrangements. Participants sit comfortably around a table or in a circle. A round table is ideal because it allows participants to see each others’ name cards. The institution provides beverages and light refreshments to keep energy high, and an easel with writing paper or a blackboard should be available so the moderator can jot down notes. The moderator should also have a private notepad where he or she takes meeting notes and writes impressions and observations. However, the moderator should not devote too much time to note-taking; it is best if the moderator’s assistant takes thorough notes so that the moderator may completely focus on the discussion. Group members should be aware that this is not a question and answer session between the moderator and group members. The purpose of the group setting is to generate a discussion that brings out new ideas from other participants.

Recording the session. It is extremely helpful to have an audio tape of the session. An audio tape can record the session exactly, whereas written notes are sure to miss some details. The focus group team can refer to the tape in times of uncertainty about the connotations of comments. For example, when John says, “The product was helpful,” does he mean “The product was helpful,” (it used to be helpful), “The product was helpful but the terms and conditions were unsuitable), or “The product was helpful,” (the product was very helpful)? The tape recorder can reveal these nuances. If the moderator chooses to use a tape recorder, he or she should candidly alert the group to its presence, and then locate it in an inconspicuous place. If the group members cannot see the recorder, they may forget it is there, in which case they are less likely to find it intimidating and more likely to speak freely.28 If you use an audio tape, the moderator should call on participants by name so that the transcriber knows who is saying what.

Getting started. Some warm-up questions (e.g. “How did you hear about MicroBank?”) may be helpful to get customers speaking unreservedly. Initial questions such as “What type of business do you operate?” and “How many loans have you had?” also help to understand the context from which responses arise. Introductions are requisite if the participants are to feel comfortable

28 Kumar (1987).
around each other, but the introductions and warm-up questions should not take more than ten to fifteen minutes.

It is helpful to start with general ideas and then move to the true substance of the discussion. For example, if the discussion is about the use of a new loan product, first talk about why a microfinance customer might need various types of loan products, then zero in on the loan product to be discussed today, and finally talk about use of that product.

It is essential that the discussion focus on current events and opinions, not recollections or memories of times past or how conditions have changed. Such topics are often fodder for unreliable discussion; memories are untrustworthy sources of information. If the question must address past occurrences, limit it to a month, e.g. “How many times have you encountered the problem in the previous month?”

The discussion should last about an hour, but if it seems to remain energetic and productive, it is not necessary to end it after that time period. At the end of the discussion, the group should agree on basic conclusions from the session and recommend solutions for the topics discussed. However, if no consensus can be reached, there is no need to force uniform conclusions.

The degree of formality to the discussion can be variable. In the case of a more structured discussion, the AIMS tools suggest a flip chart with five columns: 1) Program feature, 2) Like about feature, 3) Dislike about feature, 4) Recommended changes, and 5) Why?

![Figure 27: Illustration of the AIMS Structured Focus Group](image-url)

1. Program feature: **Forced savings**
2. Like about feature: Encourages discipline, ensures enough money to repay loan on time, allows access to next larger loan
3. Dislike about feature: Can’t accrue interest on savings, lessens total “real” loan amount, decreases personal liquidity, unable to withdraw funds
4. Recommended changes: Create an incentives program where customers can choose to borrow with or without savings
5. Why? Customers who borrow with savings receive related benefits; customers who borrow without saving must meet stricter criteria to borrow
Figure 27 illustrates this procedure. In some instances, such a formal process can help guide the session. Allowing the conversation to be less structured (though still adhering to a group of pre-determined questions) also has its advantages, e.g. encouraging a wider range of responses.

**The Moderator**

Although the moderator does not necessarily have to be trained, he or she certainly must be prepared. Among expectations of a moderator are non-judgmental responses when listening to suggestions and the ability to encourage all participants to freely voice their opinions. To achieve these qualities, the moderator should have an outgoing personality and not be personally invested in the topic to be discussed. It is unwise to put a loan officer or another familiar employee to the task of moderation, because customers may then bias their answers to what they think the moderator wants them to say, or may not want to insult the moderator by voicing their true opinions. If the moderator is to come from in-house, it may even be sensible to conceal from customers that the moderator is a member of staff. To further ensure that the moderator is neutral in his or her reactions to customer opinions, it is useful to have the note-taker observe the moderator’s interactions with group members.29

The moderator must adopt certain characteristics to be successful:

1. *He or she must know how to probe.* Probing group members gently and non-obtrusively will help the group get the most out of the session. Asking why, asking for more detail, and asking for further examples and other alternatives helps elicit further information.

2. *He or she must encourage reluctant group members.* Quiet or shy people must be brought out to participate in the discussion. A skillful moderator will gently encourage these people to add their thoughts and ideas. One way to do so is to make eye contact with quiet participants or to ask them direct questions. A simple “What do you think?” often does the trick.

3. *He or she cannot be biased.* A biased moderator will taint the reports of the group, and may even change the course of the discussion itself. One common type of bias is “consistency bias,” which occurs when she gets an idea in her head from one group and seeks to have other groups confirm that idea. The successful moderator avoids this at all costs, and does not disregard opinions from one group that conflict with opinions from another group. Likewise, she does not ignore or refuse to probe opinions that are not similar to her own opinions.

Additionally, the staff member who writes the report should not filter out information that contrasts with his beliefs. The researcher should be open to whatever conclusions the focus group reaches. Various researchers should arrive at the same conclusion based on the data.

Sampling

Sampling is a useful tool for both surveys and focus groups. Unless the customer study intends to focus only on customers from a certain group (e.g. one gender, trade group, or income level), random sampling is a way to study a group of people that is compositionally similar to the population to be surveyed, but much smaller and more manageable. Hardly any customer study will undertake the ambitious task of determining the preferences of each and every customer. Instead, sampling can be used to choose participants for surveys, focus groups, exit interviews, and any other research for which the your institution chooses to study only part of the customer population. Experience shows that the results will be almost identical (plus or minus a few percentage points) to a project that studies each and every customer.30

Probability theory dictates that randomly interviewing one out of every five customers (or one of every eight or ten) is likely to result in equal proportions of various customer segments. A small representative group is more manageable and cost-effective to study than the entire customer base, and sampling makes it unnecessary to interview so many individuals. Regardless of the population size, a sample of about 90 individuals will give you reliable results if the group is fairly homogenous, though as few as 40 can also be used for less precise results. If the group is comprised of many different sub-groups (e.g. different genders, various trade groups), make sure that there are at least 20 to 30 individuals who represent each group if you wish to obtain reliable results for each group. However, 90 individuals per sub-group will give you the most reliable results.

How to Sample

Before the advent of computers, traditional sampling often relied on randomly pulling names out of a container. Other ways to sample include picking every nth name off an alphabetical list of customers or letting a computer program generate a random list. Sampling is a simple process that will make the customer study more efficient. Many computer database programs have this capacity.

Some microfinance institutions may want to study non-customers as well as current customers to get a better idea of what services appeal to the population at large as well as how needs vary from current microfinance customers to the general populace. For this methodology to be successful, you will need to obtain (or generate) a list of the entire population of the target area (city, town, municipality) and interview a random sample of all residents. Caja Los Andes of Bolivia recently used this method to interview non-customers regarding housing loans.

Another way to sample a population for a target area is by stopping at every nth house to administer the survey. If you use this process, however, keep in mind that more affluent people usually live in the houses on the corner of the block. If each block has a consistent number of houses, making every nth house a corner house, you may end up “sampling” only the wealthy people in the neighborhood.

30 Nagarajan (2000)
**Errors and Their Consequences**

Although sampling is simple, the method must not be abused. The key here is *randomness*, i.e. the sample must be randomly generated from the entire customer population. The following three examples are some potential problems that accompany the sampling process.

1. **Non-representative sample.** The MFI staff person who is in charge of disseminating surveys for a particular branch learns that one third of that branch’s customers are small shop owners, one sixth are weavers, one sixth are vegetable traders, and the remaining one third are street vendors. He decides to interview twenty-four nearby customers proportional to the overall customer types at the branch: eight small shop owners, 4 weavers, 4 vegetable traders, and 8 street vendors. This method, though seemingly harmless, will not yield significant results:

   - The interviewer, by interviewing nearby customers of his choice, will likely interview those who seem friendly and approachable to him; perhaps they will be his friends. There is no guarantee that these customers will be of various economic or social strata.

   - Some questions may be undermined by the fact that these customers live closest to the branch, such as whether or not the branch location is convenient. The survey may determine that all customers find the branch location convenient when in actuality, most customers live very far from the branch and find the location completely inconvenient. Or, if all these nearby customers live in an urban area, they will be less likely to be interested in agricultural loan products. The list could go on and on.

   - If the survey administrator is concerned about interviewing all segments proportionally, he or she can stratify the sample by selecting certain percentages of customers based on the proportionality of the group or section. **Stratification** involves segmenting customers into prescribed groups (e.g. trade group, gender, income level, etc) and selecting a random sample of customers based on each group’s share of the entire customer base.

2. **Sampling error.** Inevitably, sampling only part of the population will reduce the overall accuracy of the study; this reduction in accuracy is called the sampling error. The statistical explanation of the sampling error is beyond the scope of this publication, but it is sufficient to note that a sample size of 90 individuals will provide a sample base that has a reasonably small margin of error. Stratification reduces the sampling error.

   - Simple random sampling will likely produce a list of customers that is representative of the entire customer base, but stratification is an extra assurance that certain groups will be proportionately represented.

   - Another measure to increase the accuracy of the findings is to increase the sample size if a small group is under-represented. For example, if a survey of 100 people
includes 35 weavers, 32 potters, 25 seamstresses, and 8 cash-crop farmers, increase the sample size by 50 percent so that the cash-crop farmers are better represented.

3. Non-compliance. If a portion of customers in the sample refuse to respond to the survey, or if participants are suddenly unavailable, the survey administration team must have a back-up plan. Since the legitimacy of the survey is invalidated if administrators hand out the survey to other customers who are easily reachable but who were not part of the sample, administrators must have a sample reserve to tap into in the case of large-scale non-compliance.

Errors can completely corrupt your efforts to measure customer satisfaction and customer loyalty, so it is imperative to watch out for them. Take steps to prevent or respond to all possible errors, and you’ll be on your way to an accurate reading of customer preferences.

Analysis

Once we have stacks of customer information, it’s time to make sense of it all. Analysis is the point at which all the effort turns into quotable facts and figures about your institution. Customer research can produce either qualitative or quantitative results. Qualitative results describe customer perceptions, suggestions, and other subjective matters. Quantitative results describe the questions of how many, to what extent, and other objective matters. Each type of results demands a distinct mode of analysis.

Data Collection and Processing

To manage and utilize results, MFIs must carefully track and interpret relevant data. Before the institution pursues any customer loyalty initiatives, it must ensure that the framework is in place to input results from customer studies. Each type of study should feed into a database of customer responses, which is coded, organized, and monitored by appropriate staff members.

Without a system for data process and analysis, the efficacy of any customer information is compromised. Creating a database may seem daunting, but it can involve various
levels of effort for MFIs of different sizes. Larger MFIs should consider creating a special unit for marketing, research and development, or customer relations that processes data collected at the branches. Where data collection occurs on an ongoing basis, if possible it should be integrated into the information system.

In smaller organizations, there is a tendency to assume that the more intimate scale allows the MFI to be more in tune with its customers, and therefore formal data collection processes are not necessary. While that may be true, we strongly recommend occasionally testing that assumption. If the organization doesn’t have the in-house capacity to do so, then outsourcing the data collection and analysis may be the preferred option.

**Qualitative Studies**

Qualitative studies rely mostly on open-ended questions that cannot be quantified due to distinctions in answers. Data that results from qualitative studies can give a good idea of customer preferences, but they can never provide hard numbers.

*Analysis of questions on loan applications, complaints solicitation strategy, and complaints and suggestions system.* Whereas charts and numbers allow for analysis of quantitative studies, the best way to aggregate and analyze qualitative data is by observation and report-writing, and for qualitative data that is written, periodically reviewing all responses and categorizing them. For example, if at the end of the month the institution has received 75 customer comment cards, the comments are tallied by type. Figure 28 illustrates a sample report.

At the end of each month, the new comment cards are tallied; a brief analysis that discusses the details of the results accompanies the form. If the category “Other” (as illustrated in Figure 28) exceeds ten percent of the total responses, it is likely that new categories can be added to complement existing ones. As months pass by, customer preferences should become apparent based on trends revealed by the analyses and forms. It is imperative that tracking the measurement system is part of one person’s job description to ensure usefulness of these tools.
Analysis of focus group sessions. Recording the session is essential to the usefulness of the focus group. If an audio device is used, the facilitators should be careful to ensure that the voices are actually recorded. Then, an employee involved with the administration of the group makes a transcript of the session and writes a report that includes the highlights from the discussion and the conclusions. The transcript also refers to notes taken by the session’s moderator and his or her assistants, if any. The report includes names and profiles of participants, their responses and their suggestions; similar responses are grouped accordingly.

Figure 29 illustrates part of a sample focus group report to management. The report should address all major themes of the discussion. It may also be helpful to keep a tally of comments similar to the “Complaints and Suggestions System” report.
Figure 29: Sample Focus Group Report to Management (excerpt)

Report to Management. Focus group #3. January 12, 6:00 p.m.

Although the moderator directed the discussion so that it would equally address all five topics (flexibility, loan products, member benefits, turn around time, and forced savings) participants were most interested in talking about member benefits. The trend was that participants used member benefits as an umbrella subject that covered the other four topics and gave that subject the most consideration. Some sample comments follow:

Susan: I think that member benefits encompass everything. Every service that MicroBank provides to me is a member benefit, including each type of loan, how fast I get my loans, and all the prerequisites that go along with taking out that loan. Also, if the staff treats me well, that is a member benefit.

(Alice and Peter agree by nodding their heads.)

John: There are a lot of other microfinance institutions out there that offer their customers the same services that MicroBank offers. If MicroBank doesn’t offer their services in a better way than the others do, it will lose its customers. Fast turn-around time is definitely a member benefit, and so is flexibility with products. Being in the agricultural business, I definitely rely on quickness and flexibility. I heard of a bank that has cash disbursal machines that customers use twenty-four hours a day. That would add to flexibility.

Participants suggested that the MicroBank adopt “member benefits” as a central theme in its operations. By focusing on member benefits, many participants said, MicroBank will attract and retain customers who value services as well as products. Superior “member benefits” will be an incentive to keep taking loans from MicroBank.

The report is sent to management and loan officers in order to have maximum information sharing of customer points-of-view. This knowledge is beneficial to any staff member who interacts with customers. After the report has been considered and analyzed, management should then make hypotheses based on the session and determine next steps: Is a targeted survey necessary to form more conclusive results? Is there enough evidence of problems, and sufficient suggestions for solutions, to make institutional changes? Or will the evidence from this focus group simply be kept on file until future focus groups corroborate the findings? These questions must be answered as management decides what to do with the results of the session. If management does decide to make changes based on the results of several sessions, the same rules that apply to surveys apply to focus groups: phase in new programs with pilot tests in order to ensure that new policies are beneficial not only to the customers but also to the institution.
**Quantitative Studies**

In many ways, analysis of qualitative measurements is mostly about observing trends. Analysis of quantitative measurements, on the other hand, is a more precise operation that requires some mathematical skill and statistical knowledge. This section will provide a brief introduction to some common data analysis tools that can apply to surveys and exit interviews. Qualitative elements of these tools, such as open-ended questions, should be treated as such (categorized, tallied, etc.).

The importance of keeping a database and practicing accurate data entry should not be underestimated. Keeping a database allows the institution to look at averages and frequencies of answers, as well as to cross tabulate information such as gender, income level, occupation, use of loan, age of customer, etc. To learn more about the uses of databases in MFIs, please see CGAP’s MIS Handbook.\(^{31}\) To learn more about cross-tabulation of customer data generated from a survey, see *Learning from Customers: Assessment Tools for Microfinance Practitioners*, an output of Assessing the Impact of Microenterprise Services (AIMS).\(^{32}\)

The following modes of analysis provide a surface review of results. Once numbers are calculated, an analyst further scrutinizes and evaluates the responses to understand the causes for customer dissatisfaction and to create solutions to the problems. One way to analyze these numbers is by plotting them on a chart or graph to illustrate how they change over time.

- **Frequencies and percentages.** Frequencies simply count the number of responses to an answer, i.e. how many customers believe that loan sizes are too small, or how many customers believe that loan terms are too short. Percentages are the ratio of frequency to the total sample.

- **Central tendencies.** Central tendencies describe the most common responses to questions. There are three types of central tendencies:

  1. **The mean (or average).** In a survey where the customer is asked to rate a service on a scale from one to ten, the mean tells what the overall rating was of all customers who were surveyed.

  2. **The mode.** The mode describes the most frequent response. In a survey of 100 people, if 45 customers describe themselves as “generally satisfied,” 10 customers describe themselves as “highly satisfied,” 25 customers describe themselves as “dissatisfied,” and 20 customers describe themselves as “highly dissatisfied,” the mode is “generally satisfied.” Even though the majority of customers did not respond that they are “generally satisfied,” that category received the most responses, making it the modal response, as demonstrated below.

\(^{31}\) CGAP (1998).

\(^{32}\) SEEP Network (2000).
3. **The median.** The median is the middle position. Technically, there should be the same number of answers below and above the median response, but often the median response is embedded within a large group. In the above example of satisfaction, for example, the median response is “generally satisfied,” because in the spectrum, the 50th person out of 100 people responded as such.

- **Cross-tabulations.** Cross-tabulations further disaggregate information learned from the surveys. Cross-tabulating is the systematic process that allows an institution to link two variables contained in the survey, as demonstrated in Figure 30. Cross-tabulating gender with the number of customers who would like insurance products helps determine if that demand is different for men and women. Cross-tabulating income or occupation with the number of customers that would like insurance products helps the institution learn which types of customers may desire shorter loan terms. Cross-tabulations can help the institution direct new policies to the specific customers who demonstrate need for them. Since the categories overlap, notice that the proportion of 567 that each category represents adds up to more than 100 percent.

- **Open-ended questions.** Open-ended questions should also be included in the database, and should not be ignored due to difficulty in reporting. They should be treated as qualitative responses.

### Figure 30: Product Preference Cross-Tabulated with Gender, Occupation, Poverty Level

<table>
<thead>
<tr>
<th></th>
<th>Highly Satisfied</th>
<th>Generally Satisfied</th>
<th>Generally dissatisfied</th>
<th>Highly Dissatisfied</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Count</td>
<td>45</td>
<td>10</td>
<td>25</td>
<td>20</td>
<td>100</td>
</tr>
</tbody>
</table>

**Errors and Their Consequences**

Calculation errors and other misjudgments can undermine the usefulness of any study. If the results are not interpreted correctly, your institution may rely on false assumptions to make procedural or product changes.

**Interpreting percentages.** If a large majority of customers report they are satisfied with services, it does not necessarily mean that demand for new or improved services should be overlooked, as the case of PRODEM demonstrates. According to a survey of PRODEM customers in two branches, Caranavi and Minero, 94 percent of Caranavi
grocery vendors were satisfied with loan amounts and 89 percent were satisfied with loan terms; in Minero, 63 percent of grocers were satisfied with their loan amount and 91 percent were satisfied with the loan term. Although it seems that the generally high levels of satisfaction should signal to PRODEM that all is well, a closer look says otherwise. The customers who were dissatisfied with loan terms and amounts include a large percentage of grocery wholesalers, who needed larger loans. It is not enough to take satisfaction levels at face value.\footnote{Lee (2000).} This situation demonstrates the importance of cross-tabulating and delineating responses by sector.

*The “independent variable” error.* Another dangerous error relates to the “independent variable.” Figure 31 is the basis for describing the error.

**Figure 31: Illustration of the “Independent Variable” Error**

<table>
<thead>
<tr>
<th>Attitude</th>
<th>Vegetable Traders</th>
<th>Seamstresses</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Happy with loan term</td>
<td>1,045 (59.1%)</td>
<td>667 (84.2%)</td>
<td>1712 (66.1%)</td>
</tr>
<tr>
<td>Would like to increase loan term</td>
<td>754 (41.9%)</td>
<td>125 (16.8%)</td>
<td>879 (33.9%)</td>
</tr>
<tr>
<td>Total</td>
<td>1,799 (100%)</td>
<td>792 (100%)</td>
<td>2591 (100%)</td>
</tr>
</tbody>
</table>

Adapted from Weisberg, Krosnik, and Bowen (1989)

Approximately 88 percent of those who would like to increase loan terms are vegetable traders (754 vegetable traders divided by 879 total customers interviewed who wish to increase their loan term). That statement is somewhat correct but also misleading. The denominator must be the total number of vegetable traders, not the total number of those who would like to increase loan terms, since the sample size of vegetable traders and seamstresses is not equal (1799 v. 792).

The statement should instead read that 42 percent of vegetable traders would like to increase loan terms (754/1799), and 16 percent of seamstresses would like to increase loan terms (125 divided by 792). Misinterpreting these results and making changes based on false analysis can lead to unfortunate results. *Always calculate within the independent variable,* in this case by trade group. The 26 point difference between the preferences of vegetable traders versus seamstresses (42 minus 16) shows a strong association between trade group and loan term preference.

**Use of Results**

It is unwise to make rash decisions based on results; instead, make calculated, gradual changes that are beneficial to both your institution and your customers. For instance, in response to the dynamic nature of both customer demand and institutional growth, ASA relaxed some of its strict policies in the late 1990s. But some unforeseen consequences followed: when ASA relaxed its policies about savings withdrawal, many customers quickly removed their savings. A run on deposits occurred, which had a temporary but
serious impact on ASA’s loan operations. Even though ASA exercised caution by only relaxing these policies in half of its branches, problems still resulted. ASA recognizes now that it should have implemented changes slowly and incrementally, in one branch at a time, because in that way management would have been more likely to foresee potential problems.\(^{34}\)

To phase in results, the survey administration team should first make hypotheses about the results, i.e. “If customers in food businesses do not receive large enough loan sizes, then good customers in that segment may benefit from parallel loans.” Then, the hypothesis should be tested by allowing parallel loans to customers who work in the food business in one to three branches. If the product is successful throughout an entire loan term, then it can be expanded to other branches. Success should be measured carefully: staff should be trained to analyze customers’ cash flow and repayment capacity to confirm that they can afford to borrow greater sums of cash. Eventually, parallel loans may be permitted to customers in other businesses as well if they demonstrate the need.

Compartamos provides an example of phased-in changes. According to a survey of 365 customers, borrowers had the capacity to repay loans between $600 and $1500. The survey also found that customers wanted a longer period for the loan term and a smaller requirement for compulsory savings. Compartamos then applied this flexible system to one branch as a pilot project in March 1999:

- Customers choose between 16 or 24 week loan terms.
- Compartamos offers loans up to $1,100 (not the maximum amount customers say they can pay).
- The first loan amount is between $60 and $150 (previously no more than $50).
- The required savings amount is reduced from as much as 17 percent to only 10 percent.

From March to September 1999, the portfolio of the “test” branch increased by more than 40 percent, the number of customers increased by more than 15 percent, the portfolio at risk greater than 30 days shrunk by 40 percent, and the customer-to-loan officer ratio increased by more than 30 percent; there were no known adverse effects. Although the period from March to September barely comprises 24 weeks (the length of the longest loan term), it was seen as a good start. During the year following the success of the original pilot test, Compartamos applied the changes to only three more branches to continue observing results. Because the success continued, all branches are now adopting the new system.

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34 Halpern (2000).
Customer loyalty is key to an institution’s long-term survival. An institution built on customer-centered principles gains customer loyalty by consistently respecting the demands of its customers. Losing customers can be costly. Promoting customer loyalty will enhance retention and improve cost efficiency by persuading your customers not to stray to other financial service providers. Your customers will benefit, too, by having their needs met.

Improving customer satisfaction does not rely only on technical expertise or exact scientific research. Actively listening to and caring for customers also goes a long way in gaining their trust and loyalty. Astute research and improved services mean nothing if the customer is not treated well. An MFI’s staff that is sensitive to customer constraints, takes their concerns seriously, and thanks them for their patronage will go a long way in retaining valuable customers and keeping them happy.

**Taking Action**

This guide has taught you that a high level of customer loyalty positively affects your institution’s bottom line, and it has taught you how to achieve loyalty among the ranks of your customers. Now that you have the tools and the know-how in hand, it’s time to take action on customer satisfaction by asking your customers what they need and how you can meet those needs. Once you know the answers, you can turn not-so-satisfied customers into satisfied customers, and turn already-satisfied customers into loyal ones. Through product design that corresponds with customer requirements, through attentive customer service and loyalty incentives, you can build relationships with customers who will soon feel your services you offer them are indispensable because you offer demand-driven products that fit your customers’ unique needs and lifestyles.

Start by considering the degree to which your institution is focused on customers.

- Do your loan officers develop strong relationships with customers?
- Does your institution take steps to understand customer preferences?
- Have your products and services been altered at least once in the past year to accommodate customer demand?
- Are branches comfortable and is service fast (e.g. places to sit, short lines, friendly service, etc.)?
- Are staff members happy with their jobs and do they enjoy working with customers?
- Do customers purchase services again and again, and do they rely on a variety of your products?

Your answers to these questions will tell you a bit about your institution’s relationship with your customers, and help you to develop a distinct plan to cultivate loyalty. Now, find out everything possible about your customers—current ones and former ones, too—and determine how to best take care of their financial services needs. Perhaps additional technology, like automatic teller machines (ATMs) or credit cards, would give them the added flexibility they need. Or maybe they just want to spend less time at group meetings. Whatever it is, you can find out through focus groups, surveys, exit interviews, and use of the other tools detailed in this guide. Once you have the information, you can tailor your supply to your customers’ demands. Finally, allow your institution to be flexible and dynamic; by permitting a bit of elasticity in your operations, you can meet your customers’ needs today, and change and grow with them far into the future.

**A Twofold Obligation**

The two sides of the dual mission of microfinance—an economic benefit for the customer and a financial benefit for the institution—converge neatly into the customer loyalty framework. Once you fully understand your customers’ needs, you can expand your product line to serve them better. A careful and meditated expansion will increase your impact on existing customers and deepen your outreach to include a wider range of individuals who need microfinance services. Increased customer loyalty is good for the microfinance industry.

But for customer loyalty to really take root, MFIs first need to train loan officers and other staff to be better marketers and service providers. The institutions themselves need to learn to creatively develop and promote products and services that are commensurate with need. For such developments to proceed, institutions must first build institutional market research and analysis capacity. In the end, market analysis will tell us far more than impact analysis can, because market analysis describes the demands of customers. If we satisfy those demands, we fulfill the first requirement of microfinance: to provide opportunities to those who the traditional financial system cannot reach.
### Appendix A: Overview of Customer Data-Gathering Tools

<table>
<thead>
<tr>
<th>Type of Tool</th>
<th>Relative Cost</th>
<th>In-House or Third Party?</th>
<th>Overall Effectiveness</th>
<th>Frequency of Use</th>
<th>For what size institution?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Failure Analysis</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exit Interviews</td>
<td>Medium to High</td>
<td>Either</td>
<td>High</td>
<td>Always</td>
<td>All Sizes</td>
</tr>
<tr>
<td><strong>Preventing Defections</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Complaints and Suggestions System</td>
<td>Low</td>
<td>In-House</td>
<td>Medium</td>
<td>Always</td>
<td>All Sizes</td>
</tr>
<tr>
<td><strong>Customer Service Desk</strong></td>
<td>Medium to High</td>
<td>In-House</td>
<td>Medium to High</td>
<td>Always</td>
<td>Large</td>
</tr>
<tr>
<td><strong>Measuring Satisfaction</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Focus Groups</td>
<td>Medium</td>
<td>Either</td>
<td>Medium to High</td>
<td>As Needed</td>
<td>All</td>
</tr>
<tr>
<td>Satisfaction Surveys</td>
<td>High</td>
<td>Third Party</td>
<td>Medium</td>
<td>As Needed</td>
<td>Medium to Large</td>
</tr>
<tr>
<td>Targeted Customer Surveys</td>
<td>High</td>
<td>Third Party</td>
<td>High</td>
<td>As Needed</td>
<td>Medium to Large</td>
</tr>
<tr>
<td>Mystery Shopping</td>
<td>Medium to High</td>
<td>Third Party</td>
<td>Medium</td>
<td>As Needed</td>
<td>Large</td>
</tr>
<tr>
<td>Questions on Loan Applications</td>
<td>Low to Medium</td>
<td>In-House</td>
<td>Medium to High</td>
<td>Always</td>
<td>All Sizes</td>
</tr>
</tbody>
</table>
Appendices

Appendix B: Additional Economic Benefits of Long-Term Customers

In the first chapter, we discussed some important economic benefits of customer loyalty. The following figures further clarify the importance of customer retention.

Figure 32 demonstrates another crucial issue: loyal customers with low loan balances are more valuable to the institution than larger borrowers who exit the program. This table separates an MFI’s existing customer base into five categories. New customers, in column A, are estimated to remain customers for an average of two and a half years and, because of the high acquisition and screening costs, generate a negative profit margin. The remaining four columns contain repeat customers who have a mixture of loyalty (high or low) and loan sizes.

<table>
<thead>
<tr>
<th>1. Key customer segments</th>
<th>(A) 1st time borrower</th>
<th>(B) Repeat borrower with low affinity and small loan size</th>
<th>(C) Repeat borrower with high affinity and low loan size</th>
<th>(D) Repeat borrower with low affinity and large loan size</th>
<th>(E) Repeat borrower with high affinity and large loan size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Average loan amount outstanding per year</td>
<td>$300</td>
<td>$200</td>
<td>$400</td>
<td>$700</td>
<td>$1000</td>
</tr>
<tr>
<td>3. Number of years likely to remain a customer</td>
<td>2.5</td>
<td>1</td>
<td>8</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>4. Multiply 2 x 3</td>
<td>750</td>
<td>200</td>
<td>3200</td>
<td>1400</td>
<td>4000</td>
</tr>
<tr>
<td>5. Average profit margin</td>
<td>-2%</td>
<td>1%</td>
<td>5%</td>
<td>1%</td>
<td>5%</td>
</tr>
<tr>
<td>6. Multiply 4 x 5 = value of the customer</td>
<td>-$15</td>
<td>$2</td>
<td>$160</td>
<td>$14</td>
<td>$200</td>
</tr>
</tbody>
</table>

In this example, it is assumed that loyal customers with low loan balances (C) will remain with the institution longer than high affinity customers with large loans (E) since the MFI may not be able to meet the needs of the latter segment over time. In addition, the profit margins for long-term customers are higher because the initial acquisition costs are amortized over time. If the institution finds greater success in promoting loyalty among customers with small loan balances, it may experience a counter-intuitive situation of profitability increasing while its average loan balance decreases. When this pattern continues over the years, the effects multiply.

Figure 33 shows how the cost savings and additional revenues of long-time customers combine to produce an increasing volume of profits over the customer’s relationship with the MFI. The relative value of each factor will depend on institution-specific details, such as its cost structure and interest rate; the end result is that loyal customers generate increasing profits. Research in other industries has determined that companies can
improve profits anywhere from 25 to 85 percent by reducing customer defections by 5 percent.\textsuperscript{35}

**Figure 33: Why Customers Are More Profitable Over Time**

\textsuperscript{35} Reicheld and Sasser (1990).
## Appendix C: Retention Ratios

Chapter 4 detailed two formulas for customer retention. Various scholars in the field, however, have put forth many other formulas, some of which were outlined by Richard Rosenberg at the 1999 MicroFinance Network Annual Conference. Figure 34 summarizes these formulas.

### Figure 34: Retention Ratios

<table>
<thead>
<tr>
<th>Formula</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Charles Waterfield/CGAP</strong>&lt;br&gt;Formula: RR = retention rate&lt;br&gt;RR = FL / LP&lt;br&gt;FL = number of follow-up loans made during the period&lt;br&gt;LP = number of loans paid off during the period</td>
<td>This formula produces a retention rate per loan cycle, so it must be annualized to look at it on a yearly basis. For instance, an 80 percent retention rate on three-month loans means that only ((0.80)^4 = 41) percent of the customers who are active at the beginning of the year are still active at the end of the year. The formula does not include effect of default, because the denominator is loans paid off.</td>
</tr>
<tr>
<td>Variation of Waterfield/CGAP:&lt;br&gt;RR = (L - NC)&lt;br&gt;AC&lt;sub&gt;begin&lt;/sub&gt; + L - AC&lt;sub&gt;end&lt;/sub&gt;&lt;br&gt;RR = retention rate&lt;br&gt;L = number of loans made during the period&lt;br&gt;NC = number of first time customers entering during the period&lt;br&gt;AC&lt;sub&gt;begin&lt;/sub&gt; = number of active customers at the beginning of the period&lt;br&gt;AC&lt;sub&gt;end&lt;/sub&gt; = number of active customers at the end of the period</td>
<td>This formula restates the above formula in a way that is more complex but uses information that may be easier for some MFIs to produce.</td>
</tr>
<tr>
<td><strong>Default Formula</strong>: RR = retention rate&lt;br&gt;RR = FL / LP + WO&lt;br&gt;FL = number of follow-up loans made during the period&lt;br&gt;LP = loans paid off during the period&lt;br&gt;WO = loans written off during the period (or otherwise classified as unlikely to be repaid)</td>
<td>This formula reflects the effects of default by producing a retention rate for performing borrowers. It is imperfect in some other respects. It would be useful only if the MFI has a sound write-off policy and applies it consistently.</td>
</tr>
<tr>
<td><strong>ACCION Formula</strong>: DR = desertion rate&lt;br&gt;AC&lt;sub&gt;begin&lt;/sub&gt; = number of active customers at the beginning of the period&lt;br&gt;DR = AC&lt;sub&gt;begin&lt;/sub&gt; + NC - AC&lt;sub&gt;end&lt;/sub&gt;&lt;br&gt;NC = number of first time customers entering during the period&lt;br&gt;AC&lt;sub&gt;end&lt;/sub&gt; = number of active customers entering during the period</td>
<td>This formula will not work for a start-up program, where AC&lt;sub&gt;begin&lt;/sub&gt; is zero. To obtain a retention rate, subtract the desertion rate from one.</td>
</tr>
<tr>
<td><strong>Mark Schreiner Formula</strong>: AC&lt;sub&gt;begin&lt;/sub&gt; = number of active customers at the beginning of the period&lt;br&gt;NC = number of first time customers entering during the period&lt;br&gt;AC&lt;sub&gt;end&lt;/sub&gt; = number of active customers entering during the period&lt;br&gt;DR = AC&lt;sub&gt;begin&lt;/sub&gt; + NC - AC&lt;sub&gt;end&lt;/sub&gt;&lt;br&gt;DR = desertion rate&lt;br&gt;RR = AC&lt;sub&gt;end&lt;/sub&gt;/&lt;br&gt;AC&lt;sub&gt;begin&lt;/sub&gt; + NC</td>
<td>This formula is similar to the ACCION formula, but it can be used for start-up operations.</td>
</tr>
</tbody>
</table>

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Bibliography


Nagarajan, Gheetha, PhD. Personal interview. October, 2000.


