

Analysis of Dropout Behaviour Among Borrowers of Microfinance Sector in Bangladesh

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ABSTRACT

This paper estimates the dropout behaviour of borrowers with the household level data of a specialized programme called PRIME (Programmed Initiatives for Monga Eradication) targeted in the North Bengal region of Bangladesh, consisting data of six rounds (2008-2013) on around 16000 observations. It was observed that the dropout rate was lowest for the PRIME credit plus households, implying that non-financial services along with financial ones have greater impact on borrowers' satisfaction. Our analysis also showed that female-headed households and wage-earning households were more probable to exit. They are the weakest and most vulnerable groups. Our econometric analysis showed that programme characteristics had a great impact on the dropout decision irrespective of any microfinance programme. If the programme includes additional services along with loan such as training, healthcare and livestock services, then the probability of dropping out would be lower. This is where PRIME credit plus works well in reducing the dropout rate of those households that, in particular, received both credit and non-credit interventions. This implies that Microfinance Institutions (MFIs) should deepen the non-financial interventions, particularly, for the vulnerable households. The higher intensity of drop out among the female headed as well as wage earning members probably suggests that the programme design of MFIs should be flexible for the vulnerable female headed or wage earning households.

Keywords: dropout behaviour; microfinance programme; logistic analysis; Bangladesh

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Introduction

Microfinance has been regarded as one of the most crucial policy tools for enhancing the livelihood of poor people in developing countries through giving them access to financial services. Researchers and practitioners in the development field believe that the access to financial service is one of the prime conditions for poverty reduction. This is because with financial services, poor people can smooth consumption by participating in income-generating activities. The early studies of Udry (1994), Besley (1995), Morduch (1995), (1998) show the evidences that microfinance helps in consumption smoothing by playing an insurance role during shocks. The ripple effect of microfinance is also remarkable. It plays a positive role in providing better nutrition, education and medical facilities along with empowering the beneficiaries. In spite of the excellent achievements of microfinance in providing financial services to the poor, it is still experiencing difficulties to attract borrowers for the long term and thus struggling to attain financial sustainability.

Client drop out has adverse impact on both borrowers and Microfinance Institutions (MFIs). While most MFIs acknowledge the significance of client retention, very few have designed business strategies to maximize customer loyalty (Churchill, 2000; Islam, 2011). Competition has increased among MFIs in terms of

product development, service offered, customer relationship and management efficiency (Khavul, 2010). Retaining clients is crucial for the survival of MFIs because it can not only reduce the administrative costs, but it can also decrease default risks (Pagura et al., 2001; Mustafa, 1996). Microfinance profitability depends on retaining clients' loyalty and clients' satisfaction to a great extent (Nawaz, 2010; Shahriar, 2012). Satisfied clients attract new clients, which maximizes membership participation into the MFIs (Kotir and Obeng-Odoom, 2009; Shahriar, 2012). Microfinance practitioners have recognized the importance of customer retention as it costs the MFIs more to acquire new customers than to satisfy and retain existing customers (Westover, 2008; Islam, 2011).

Though the issue of drop out in the microfinance sector is not very new, few studies have addressed this issue in detail. Some studies during the mid 90s such as Hasan and Shahid (1995); Khan and Chowdury (1995); ASA (1996); Mustafa, et al., (1996); Hulme and Mosley (1997); Wright (1997); and Pagura (2003) have discussed the dropout issue extensively. However, in recent years, no detailed study on the dropout issue in Bangladesh has been conducted. Re-examining the dropout issue is thus crucial. It is also important to note that, despite the successful performance of Bangladesh in this sector, the MFIs are yet to achieve sustainability to a great extent. As the ultimate goal of any microfinance programme is to

provide financial services to the poor in a sustainable manner, financial self-sufficiency becomes of major importance, especially when the donors tend to slash the subsidies over time. Therefore, addressing the determinants of the dropout issue and recommending appropriate policy for mitigating this problem may help to achieve sustainability of any microfinance programme to some extent.

It is interesting to note that while many have dropped out of MFIs, many have also continued their membership for years. The question is why some exit from the market and why some remain in the market. Keeping this question in mind, we attempted to investigate what factors determine the drop-out decision of borrowers. We intend to find out both the institutional factors and demand side factors influencing drop out. This paper analyses the household level data of a specialized programme called PRIME (Programmed Initiatives for Monga Eradication) targeted in the North Bengal region of Bangladesh, consisting data of six rounds (2008-2013) on around 16000 observations. PRIME is a multidimensional programme designed and initiated by Palli Karma Shahayak Foundation (PKSF) in 2006 targeted in “Monga” (near famine situation) prone areas of North Bengal. The components of the programme are micro credit, savings, training, technical assistance and health services. The central objective of this paper is to address the issue of dropout behaviour of PRIME

households. In the first step, we estimated the dropout rate, and then we identified the characteristics of drop out and continued membership households. Next we assessed the determinants of such dropout behaviour. Lastly we conclude the paper with the key findings and recommendations.

What determines the dropout decision of borrowers?: Evidence from Literature Review

Members decide to drop out due to many issues. Maybe the microfinance programme they joined failed to meet their expectation, maybe they faced some financial loss and had difficulties in repaying the loan or maybe they decided to drop out due to some external factors such as natural calamities, seasonal shocks or economic downturn, political instability and so forth. Though few studies in recent times have assessed the reasons for drop out, the findings are truly worthy to mention. Almost all the studies have pointed out some common reasons, such as dissatisfaction among clients with poor product design, business failure of clients, socio-economic characteristics of borrowers.

The literature suggests that a standard loan contract does not satisfy the requirements of all clients (Wright, 1997; Weller, 2002; Cohen, 2002 and Marin et al.; 2002; Hume, 1999). Brahman and Brahman (2014) conducted

a study on Bangladesh and found that demand for large-sized loan, delay on loan disbursement, high interest rate, natural disaster, staff attitude towards clients, institutional regulatory policy are major reasons for client drop out from MFIs. Urquizo (2006) also argues that the mismatch between demand and supply may encourage many clients to drop out from the institution and exit from the market. There have been quite substantial changes in the loan contract and more flexibility has been introduced. In Bangladesh, substantial changes have also been made based on the experiences of two decades. Separate programme designs exist for the moderate poor and the extreme poor. The extreme poor require beyond credit. Although the design is flexible, both weekly instalments and weekly meetings are commonly practised as the participating partner MFIs also apply these in normal or traditional credit programmes. Several authors showed that the nature of the economic activities, for example seasonality, that the borrowers are engaged in have a bearing on repayment. When the cash flow and the repayment schedule do not match, borrowers may be forced to exit from the institution or the market (Graham et al., 2001; Mosuna and Coetzee, 2001; Wright et al., 1998).

Results and Discussion

Trend in Dropout Rate

Drop-out rate is defined and measured in terms of exit from the market.

It is also important to note that we considered those households as drop out who discontinued their membership for two successive years and never re-joined.

In this paper, we followed the concept of CGAP technical note while calculating the client annual dropout rate, which is as follows:

$$DRR = 1 - [AM_t / (AM_{t-1} + TNM_t)]$$

Where:

AM_{t-1} = number of active households at the beginning of the period t-1.

TNM_t = the number of new (first time) households during the period t.

AM_t = the number of active households at the end of the period t

DRR = Dropout rate

As we mentioned earlier, PRIME is a special programme that consists of both financial and non-financial service. We can compare the dropout rates of the group that has taken both credit and nonfinancial service with the group that has taken only credit but no other services like training, health care or technical assistance. We defined households that have taken both financial and non-financial services from the PRIME programme as PRIME credit Plus (PCP) households. Households that had taken only credit but no non-financial services from PRIME were defined as PRIME credit only (PCO) households. Our sample also consisted of households from the traditional microcredit programme that offers only credit. We defined

them as non-PRIME credit only (NPCO) households. We estimated the dropout rate for all these three groups.

Table 1
Estimates of Annual Dropout Rate

Year	Annual Dropout Rate		
	(PCP)	(PCO)	(NPCO)
2008	-	-	-
2009	-	22.7	14.4
2010	5.2	13.2	12.1
2011	3.5	14.1	13.3
2012	3.3	6.7	6.2
2013	5.2	15.7	19

It was observed that the annual dropout rate varied by participation status. PCP households had the lowest dropout rate – less than 6 per cent. On the other hand, PCO and NPCO households had an average annual dropout rate of around 15 per cent and 13 per cent respectively. The clearer picture emerged when we analysed the cumulative dropout rate. At the end of 2013, we compared the cumulative dropout rate of the households who joined in previous years. For example, the dropout rate for PCP households who joined the programme in 2008 and dropped out at the end of 2013 was 20 per cent. The figure was 47 per cent for the PCO and 37 per cent for the non-PCO households. We have always found that credit with non-financial service group has shown a better performance than the credit only group. Non-financial interventions may have contributed to the lower dropout rate of the PCP households.

Who Exited from Micro Credit Market?

After we observed the dropout rate, a natural question arose as to who exited from the micro credit market. The answer to this question may suggest that not every extremely poor household will find a special microcredit programme like PRIME very useful if we find the characteristics of the drop-out and the continuing members are different. We present the basic characteristics in Table 2. It is clear from the table that in both the cases of PRIME and non-PRIME, weaker households with similar characteristics exited from the market. Households with lower income, more dependency on wage employment, lower size of assets, smaller amount of savings and headed by females dropped out of the credit market. In other words, the households that were vulnerable dropped out from the micro credit market. To validate this point we also calculated the cumulative dropout rate for female-headed households, wage-earners, self-employed in agriculture and non-agriculture in Table 3. The table shows the dropout rate for these groups at the end of 2013 irrespective of their joining years for PCP, PCO and NPCO. It was observed that at the end of 2013, 66 per cent and 63 per cent of female-headed households from the PCO and NPCO group dropped out.

This indicates one of the possible reasons for the high dropout rate for the PCO and NPCO groups in Table 1 and Table 2. As these groups

Table 2
Household Characteristics of PRIME & Non-PRIME (Percentage)

	Current PRIME households	Dropout PRIME households	Current Non-PRIME Households	Dropout Non- PRIME
Household head age	43.29	45.94	43.78	45.86
Household head education	1.5	1.00	1.5	1.3
Access to electricity (percentage)	26	13	24	17
HH head occupation (Wage Earner) (percentage)	44	52	44	51
HH head occupation (Self-Employment in Agriculture) (percentage)	14	9	13	12
HH head occupation (Self-Employment in non-Agriculture) (percentage)	38	27	38	28
Female Headed Household (percentage)	6	18	6	14
Household Size	4.37	3.87	4.39	4.02
Average loan size	9819		10,827	
Annual Income (Tk.)	72,806	59,069	74,002	59,342
Annual Assets (Tk.)	197,947	124,199	197,580	142,844
Annual Savings (Tk.)	11,120	3,627	10,473	4,137

Table 3
Dropout Status at End 2013 (percentage)

	Female-headed	Wage-earner	Self-employed (agriculture)	Self-employed (nonagricultural)
PRIME Credit Plus (PCP)	28.85	15.79	12.31	8.66
PRIME Credit Only (PCO)	66.67	40.72	43.62	30.61
Non-PRIME Credit Only (NPCO)	63.9	39.88	37.59	31.64

contained a higher number of female-headed households, we observed a higher dropout rate in these groups compared to the PCP group. We also observed in Table 3 that households headed by wage-earners had a higher dropout rate as compared to those self-employed, whether in agriculture or non-agriculture.

Although female-headed or wage-earning households had a higher probability to exit from the market, as evident from the descriptive statistics shown in the above two tables, not all female-headed households or all wage-earning households dropped out of the micro credit market. Some households exited from the market, and others had not. In order to understand the circumstances that led to the exit for some of the female-headed households or wage-earning households, we prepared a few case studies to complement our findings. We presented two cases for each of the groups – one that dropped out and another that did not to be able to understand the drivers for dropping out or not dropping out of the market.

Before going to the econometric results, we first discuss some of the descriptive results of our survey. During our survey, we asked the households that dropped out the reason for cancelling their membership. Table 4 reports some of the major reasons. The majority of respondents mentioned submitting regular deposit and weekly repayment as the crucial reasons for membership

cancellation. It is important to note that our sample consisted of ultra poor households. It is not surprising that they would face hardship in maintaining the regular deposit and weekly repayment policy. Around 23 per cent and 21 per cent of respondents cited regular deposit and weekly repayment as the reason for the drop out respectively. It is important to note that more than 7 per cent of members that dropped out found the rules of MFIs too complicated for them. This leads to the recommendation that the rules and regulations of MFIs should be user friendly, considering the fact that most borrowers do not have adequate education to understand complicated rules. Also, MFIs should have flexible repayment and deposit policy, keeping in mind that these ultra-poor households are very vulnerable and prone to any kind of shocks. Table 4 shows that almost 9 per cent of borrowers that dropped out could not take the burden of repayment as they faced some sudden unwanted expenditure. The higher interest rate charged by MFIs was also stated as one of the crucial reasons for dropping out.

Econometric Findings

Demand Side Factors Affecting Dropout Behaviour of Borrowers

We conducted a logistic analysis for investigating whether socio-economic factors of the borrowers had any impact on their dropout behaviour. A logistic regression will model the chance of an outcome (in this case being

Table 4
Reason for Membership Cancellation (Percentage)

Failure to submit regular deposit	23.16
Failure to maintain weekly repayment	21.21
Unable to repay due to excessive sudden expenditure in family crisis	8.87
Unable to receive loans	7.81
Unable to cope with complicated MFI rules	7.10
High loan interest rate	6.03

drop out or not) based on individual characteristics such as receiving PRIME components and other socio economic characteristics. Because chance is a ratio, what will be actually modeled is the logarithm of the chance given by:

$$\text{Log} \left(\frac{P}{1-P} \right) = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k$$

where P indicates the probability of an event or outcome (e.g., drop-out or not), and β_i is the regression coefficients associated with the reference group and the X_i explanatory variables. In our case, the logistic model would be:

$$\text{Logit} (P(X_{ij})) = \text{Log} \left(\frac{P(S_{ij})}{1-P(S_{ij})} \right) = \beta_0 + \beta_1 \text{Log}(Y_{ij}) + \beta_2 Z_{ij} + \epsilon S_{ij}$$

Where,

Logit (P(X_{ij})) = Log of odds ratio of dropout status (dummy variable) of household i in division j

Y_{ij} = programme benefits (i.e. PCP or PCO member) (dummy variable) of the household i in division j

Z_{ij} = Vector of Household's socio-economic characteristics like household head's age, gender, occupation (dummy variable), education, household size, household's access to electricity, etc.

ϵS_{ij} = Nonsystematic error reflecting, in part, unmeasured determinants of X_{ij} that vary over households.

We conducted two sets of econometric analysis of the determinants of drop out. One set showed the household characteristics determining exit from the micro credit market, and the second set showed the institutional characteristics influencing exit from the market. We used Logit technique to estimate the probability of dropping out for a set of households who were members of any microfinance institution during 2010-2013. We used household characteristics as the variables, as shown in Table 3, to explain the difference between the continuing participants in the microfinance programme as opposed to the participants who exited from the market. The results showed that vulnerable households were more likely to exit from the micro credit market. As stated above, these households were female-headed or had wage-earning household heads. These households were low income. Village level characteristics also explain the drop out.

Table 5
Demand-side Factors Influencing Drop Out

Variables	Drop Out (Odd Ratio)
Household head age	1.018***
Household head education	0.963**
Household head occupation (wage-earner)	1.258***
Household head female	3.739***
Household size	0.789***
Household Income	0.999**
PRIME Household receiving Credit Plus	0.165***
PRIME Household receiving Credit Only	3.957***
Household having electricity access	1.114
Number of MFIs in the village	0.880***
Distance of Household from Pucca Road	1.127***
Distance of Household from market	0.936***
Constant	0.124***
Observations	14,164

The odds ratio of age indicates that increase in age increases the probability of drop out by 1.018 times. It corroborates the argument of Hulme et al., (1999); Mosuna and Coetzee (2001); Hussain (2003); and Pagura (2003) who found significant relationship with age and dropout behaviour. This is because older people have less opportunity for work and hence it is difficult for them to repay the loan. Female-headed households also increase the probability of drop out by almost 4 times than that of male-headed households. This supports the arguments of Karim and Osada (1998). It is expected that women face a more unfavourable environment

than men due to restricted mobility and conservative perception in society. The result also shows that household heads with wage employment as occupation had a higher probability to exit from the credit market by 1.258 times than that of self-employment in the agriculture and non-agriculture sectors. Our econometric result shows that a higher income reduced the probability of drop out significantly. This is expected as the beneficiaries of micro finance are more likely to stay because of diversified loan products and other services which help them to generate more income. This also supports our theoretical argument that income significantly influences the dropout decision.

Table 6
 Supply-side Factors Influencing Drop Out

Variables	Drop Out (Odd Ratio)
Members received only loan but no service (lagged value)	0.305***
Members received loan and training (lagged value)	0.253***
Members received loan and health service (lagged value)	0.251***
Members received loan, training & livestock service (lagged value)	0.685
Members received loan, training, livestock & health service (lagged value)	3.82
Constant	0.152***
Observations	16254

The significant odd ratio of 'PRIME households receiving credit plus services' suggests that receiving services such as training, livestock care and health services decrease the probability of drop out by 9 times than non-PRIME households and PRIME households receiving credit only. Moreover, it was observed that PRIME households receiving only credit had a higher probability of drop out by almost 4 times than that of other borrowing households in the sample. The regression result also shows that larger family size decreased the probability of drop out by 1.26 times. It was also observed that education attainment of household head significantly influenced the household to continue the borrowing relationship with MFIs. This supports the argument of Pagura (2003). One important observation from the result is that households facing idiosyncratic shock had a higher probability of dropping out from microfinance as argued in our theoretical model.

Supply Side Factors Affecting Dropout Behaviour of Borrowers

We have so far identified the household characteristics that affect drop out. But programme characteristics also matter in drop-out. Programme design contributes to the drop out decision of the households (Woller, 2002; Cohen, 2002; Matin et al., 2002; Urquizo, 2006). We regressed PRIME interventions on the drop out to find out whether the dropout rate varies with the nature of intervention received. As not all PRIME households received all interventions, we classified the households with combination of interventions received. We introduced lagged variables as the benefits of different interventions can be derived in the following year. This will shed light on the effectiveness of PRIME non-credit interventions. The results are reported in Table 6.

We found that PRIME design has a great impact on drop-out incidence. Households receiving training or

health service along with loan had significantly lower probability of drop out than households who received only loan. Both variables show almost the same probability of drop out. However, it was observed from the analysis that households receiving more than one service along with loan did not show significant results. It is because our sample contained a very small number of observations receiving more than one service along with credit. However, the result justifies that credit and non-credit interventions together reduce the probability of drop out. Because of this, we can justify the effectiveness of a programme like PRIME.

Conclusion and Policy Implication

This study critically evaluates the reasons for drop out from microfinance programme. Additionally, it also compares the dropout trend from PRIME and non-PRIME institutions. The findings show that the dropout rate from the PRIME programme is slightly higher than from non-PRIME institutions. The dropout rate for the PRIME programme for the period 2008-2013 was around 17 and 43 per cent (for PCP and PCO respectively) whereas for the non-PRIME institutions, the rate was around 55 per cent, which implies that non-financial services along with financial ones have greater impact on borrowers' satisfaction. The result also shows that factors affecting drop out are multidimensional. As suggested in the literature, both

demand-side (such as household level characteristics) and supply-side factors (such as programme characteristics) affect the dropout decision. It is evident from the analysis that regardless of being a member of PRIME or non-PRIME institution, factors such as household-head's age, household size, household head's occupation, income, savings of household, household having access to electricity, household headed by females affect drop out incidence. The result also shows that programme characteristics have a great impact on the dropout decision irrespective of microfinance programme. If the programme includes additional services along with loan such as training, health care, livestock services, then the probability of dropping out will be lower. This is where PRIME credit plus works well in reducing the dropout rate of those households, in particular those that have received both credit and non-credit interventions. This implies that MFIs should deepen the non-financial interventions, particularly for vulnerable households. The higher intensity of drop out among the female-headed as well as wage-earning members probably suggests that the programme design of MFIs should be flexible for vulnerable female-headed or wage-earning households.

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