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Financial Education and Loan Default Behaviour in Rural Microfinance Systems: Evidence from Structural Equation Modelling in Cameroon

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Abstract

The biggest operational threat to microfinance institutions is likely the absence of financial education for MFI clients. This study attempts to investigate the effect of financial education of MFIs' clients on the rate of loan default. The study employed an opportunistic sampling technique to source data from loan officers of 60 randomly selected microfinance institutions affiliated to CamCCUL in the North West Region of Cameroon. The collected data were analysed using the SMART PLS software program and Microsoft Excel. The Structural Equation Model (SEM) was used to establish the effects of customers' financial education on loan default rate. The results from the SEM regression coefficients revealed that the lack of money management education, debt management education and financial negotiations education by MFIs' clients contributes 49.2% to the loan default rate in MFIs. Therefore, if these MFIs invest more in educating their clients on financial education skills, the loan default rate will decrease. The study, therefore, recommended that the management of MFIs should invest in the financial education of their clients, as this will go a long way to increase their ability to handle their financial obligations, thus reducing the loan default rate

Keywords:

Customers' Financial Education, Loan Default Rate, Microfinance clients, Microfinance institutions and Structural Equation Model, Rural setting.

1. Introduction

Financial services for the poor, often referred to as microfinance, cannot solve all the problems caused by poverty but can help put resources and power into the hands of poor and low-income persons (Yunus, 2007). This can permit them to make everyday decisions and chart their own paths out of poverty. However, low levels of money management knowledge deter clients and potential clients of microfinance from understanding and efficiently utilising the range of products and services available to them. According to Cole & Fernando (2008), choosing among the growing number of microfinance products requires a lot of information and skills to calculate costs, project cash flow needed to make repayments and weigh alternatives.

Given the increasing commercialisation of microfinance and the entry of for-profit players in this sector, financial education is seen as a means to enhance client protection by adopting fair and transparent pricing, effective communication, sensitivity to over-indebted clients, and ethical behaviour of staff. Financial education initiatives give clients the knowledge, skills, and confidence to understand and evaluate the information they receive and empower themselves to purchase the financial products and services that meet their needs and those of their families (Rutledge, Annamalai, Lester, & Symonds, 2008).

According to Harnisch (2010), educating customers about financial services is a growing economic and social concern garnering greater attention from consumer advocates, researchers, governments and their agencies and those concerned with policy making. Many factors have resulted in a multitude of specialised financial services marketplace that recommends consumers be fully engaged if they are to manage their finances effectively. The forces of technology as well as those of market innovation, pushed by increased competition, have given rise to a sophisticated industry where consumers are offered a wide spectrum of services by a broad array of providers. As concerns consumer issues, such as visible issues of predatory lending, high percentages of consumer debt, and low levels of saving, according to Jackson (2001), have accelerated the urgency surrounding customers' financial education. In this light, Jurg (2000) holds that factors attracting more attention to financial education include the increase in consumer debt levels, the decline in personal saving rates, and the rise in non-business bankruptcy filings.

For many years in Cameroon, the micro-finance sector has evolved and has been transformed into a system of provision of short-term loans, savings, credits, money transfers and other activities. According to Fotabong (2008), this evolution was thanks to various financial sector policies and programs undertaken by the government since independence. MFIs are now the primary sources of funds to small and medium-sized enterprises in Cameroon.

Consumers must confront complicated financial decisions in today's demanding financial environment, and financial mistakes made in life can be costly. People often find themselves carrying large amounts of loans or credit card debt, and such entanglements can hinder their ability to accumulate wealth (Lusardi et al., 2009). The success of policymakers in financial institutions therefore depends fully on the accumulated knowledge of customers on financial services.

For Sebstad et al. (2006), increasingly, many poor people are really ill-equipped to make informed financial decisions, particularly in the context of accelerated proliferation of new financial products from banks and other consumer entities. The lending terms generally are less flexible than for informal sources, and the consequences of delinquency are more profound (Sebstad et al., 2006). The market research further confirms that people usually learn about managing money informally through personal experience and from family, friends and peers rather than formal education. While poor people recognise the negative consequences of poor money management and the importance of financial literacy, they tend to see "financial education" as a luxury meant for the rich.

The findings of Cohen et al. (2004) focus more on the impact that financial education has on the participants of financial education programs just before and after exposure to the programs. Their findings are limited to the relationship between the financial education delivered and changes in knowledge, skills and attitudes and changes in financial behaviours of participants following exposure to financial education. Many studies have focused on the relationship rather than investigating the causal linkages between financial education and it implication on loans. Equally little or no research has been conducted on financial education taking into consideration its effects on the microfinance institution in the context of Cameroon.

A key question for microfinance institutions is whether delivery of financial education to clients and potential clients can help improve the financial performance of the institution. This forms the foundation of this paper, which hopes to determine the effects of financial education on loan default rate in microfinance institutions in Cameroon.
The remainder of this paper is structured as follows. Section 2 will present the literature review. Section 3 will present the research methodology, while Section 4 will focus on the results and discussions of finding and Section 5 will discuss the results and conclude the paper.

2. Literature Review and Hypothesis Development

Financial education involves teaching the knowledge, skills and attitudes required to adopt good money management practices for earning, spending, saving, borrowing and investing. Providing financial education can be of benefit to microfinance institutions (MFIs). Institutions that provide financial education can attract more customers, since better informed clients will be more willing to use financial services if they more clearly understand them. Institutions offering education may also gain greater customer loyalty, superior feedback and market information that can be used to improve their products and services and remain competitive. All in all, financial education is dubbed a 'win-win' relationship for both clients and MFIs (Cohen et al., 2004).

Various MFIs offer a wide variety of education services, ranging from consultancy and advisory services, sensitisation, vocational skills training, literacy training and economic services like capacity building for poor entrepreneurs and business development services (Goldmark, 2006).

Default refers to a situation where a borrower fails to repay a loan. It occurs when a borrower cannot or will not repay the loan and the MFI no longer expects to receive payment (Maina and Kalui, 2014). Default can be of two types, which are debt service default and technical default. Debt service default occurs when the borrower has not made a scheduled payment of interest or principal, while technical default occurs when an affirmative or a negative covenant is violated. However, the latter is not very common in microfinance institutions but mainly applies to banks. Loan default has been identified as probably the single largest reason for the downfall of institutions involved in the provision of credit. Thus, the goal of achieving a minimum loan default rate to ensure a healthy loan portfolio will ultimately lead to the sustainability of MFIs (Mensah, 2013).

The growing literature on client education or financial literacy suggests that consumers' knowledge of basic financial principles and products is quite scarce, and that it may not be sufficient to guarantee that households make sound financial decisions. For instance, more financially illiterate households are more prone to lack of planning for retirement, portfolio underdiversification, and over-indebtedness (Guiso and Jappelli, 2005; Kimball and Shumway, 2006; Lusardi and Mitchell, 2006, 2007).

The Organisation for Economic Cooperation and Development's (OECD) landmark study on improving financial literacy concluded that financial understanding is low among consumers across their 30 member countries and that consumers, among other things, feel that they know more about financial matters than is actually the case. The surveys also reported that consumers believe that financial information is difficult to find and understand (OECD 2005). Hilgert et al. (2003) formed a "Financial Practice Index" based upon (self-benefiting) behaviour in cash-flow management, credit management, saving and investment practices. When they compared the results of this index with scores on a financial literacy quiz, they found a positive relation between financial literacy scores and Financial Practices Index scores. Their results suggest that financial knowledge is related to financial practices. Although financial behaviour seems to be positively affected by financial literacy, the long-term effects of financial education on financial behaviour are less certain.

Dalla et al. (2021) evaluated the impact of an entrepreneurial and money management training program conducted at the Institute for Indian Mother and Child (IIMC), a non-governmental development organisation offering microfinance services in an extremely poor context. They found that most of the estimated effects are positive and significant, although some teachings provided advantages only to specific categories of beneficiaries, and others did not reach the desired effect. Significant outcomes were found on improved capabilities in separating personal and business finances, maintaining business records, and calculating profits, which are the main objectives of the training offered by MFIs to their clients (McKenzie and Woodruff, 2014). The estimated effects lasted even more than 3 months after the completion of the course, although a small reduction of the impact was observed over time. The study also confirms that these borrowers' positive results are associated with positive outcomes for the MFIs whose clients received the training. In particular, it was found that the number of missing or delayed repayments decreased significantly for the treated borrowers.

Financial education programs for the poor are relatively new in developing and transition countries. Microfinance opportunities (MO) and Freedom from Hunger have initiated several of these financial education programs with seven partner organisations. They argued that financial literacy is critical for improving money management skills and promoting asset-building for the poor, as well as helping microfinance clients and other poor people improve management of their assets by building knowledge of key financial concepts and developing skills to make informed financial decisions (Cohen M. et al., 2004). The main issue here is that these financial education activities, which are still at an early stage, have been developed using a learner-centred approach to education design.

Vinita et al. (2015) measured the level of financial awareness of MFI clients in the context of rising concerns over financial literacy, consumer protection, and reckless lending, which was limited to the effect of financial awareness on the part of the MFIs' clients and did not study the effect of financial awareness on the microfinance institution.

Lucia et al. (2021) evaluated the impact of an entrepreneurial and money management training program conducted at the Institute for Indian Mother and Child (IIMC), a microfinance service provider in an extremely poor context. The estimates suggest that the course had a positive and significant impact on the beneficiaries in the form of improved participation in household empowerment, working life, and enhanced money management skills. But the benefits on the part of the MFI in terms of a reduced number of missed or delayed loan repayments were not clearly brought out. Moreover, the other drawback is that these studies were conducted with few independent variables.

This paper will use the previous studies as a benchmark to include facts and theories, which eliminate the above-mentioned flaws. This paper, therefore, seeks to add to the existing store of literature on the effects of financial education of MFIs' clients on the rate of delayed or defaulted loan instalments in Cameroon. Thus, from the above literature, we formulated the following research hypotheses;

$H_0$1: Money management education does not affect the loan default rate of microfinance institutions in Cameroon.

$H_0$2: Education on debt management does not affect the loan default rate of microfinance institutions in Cameroon.

$H_0$3: Savings management education does not affect the loan default rate of microfinance institutions in Cameroon.

$H_0$4: Education on financial negotiations does not affect the loan default rate of microfinance institutions in Cameroon.

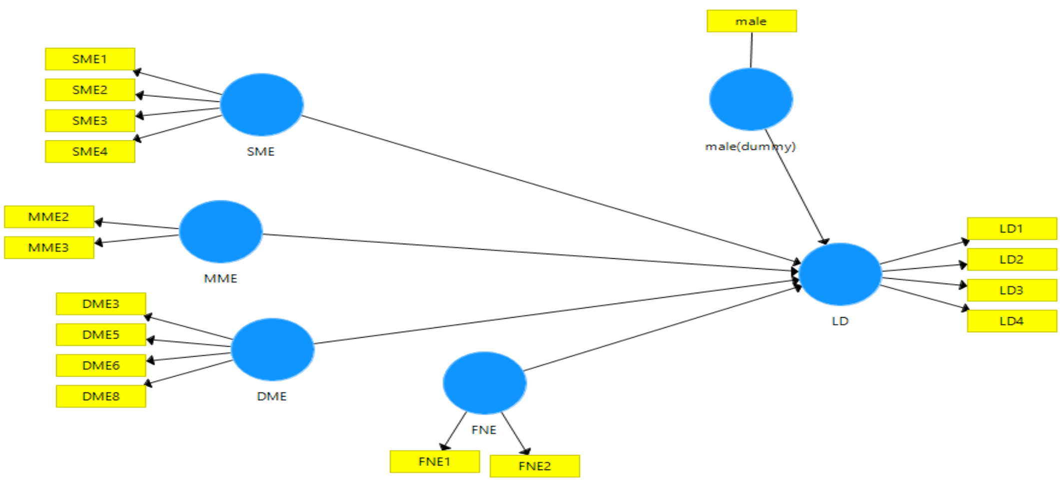
3. Methodology

The study adopted the descriptive and inferential research design. The major purpose of descriptive research is the description of the state of affairs as it exists at present (Tanah, 2012). The inferential research design was also deemed fit for this study, since it described the relationship and effects between the financial education of clients and the loan default rate of Microfinance Institutions in Cameroon. This approach was also appropriate for this study since the researchers collected detailed information through description, which was useful in identifying variables and hypothetical constructs.

Questionnaires were used to collect responses from a sample of 60 credit officers representing each of the microfinance institutions affiliated to CamCCUL in the North West Region of Cameroon.

The Structural Equation Model (SEM), which is a comprehensive statistical approach to testing hypotheses about relations among observed and latent variables (Hoyle, 1995), was used to establish the effect of financial education on the loan default rate of MFIs affiliated to CamCCUL Ltd. The Structural Equation Model, which has been formulated to guide this research, can be presented using a path diagram as seen in Figure 2 below:

Figure 2: Structural Equation Model Path Diagram



Source: Generated by authors using SMART PLS

The variables of the study have been described as seen in Table 1 below:

Table 1: Description of Variables

Variables	Description	Notations
Money management education	Measures MFIs credit officers' degree of agreement on whether or not their clients manage business money well as an indication that they are equipped with money management knowledge.	MME
Debt management education	A measure of MFIs credit officers' degree of agreement on a five-point scale on whether or not their clients have been applying strategies that help to lower their current debt and move toward eliminating it, indicating whether or not they have been educated on debt management skills.	DME
Savings Management Education	A Measure of MFIs credit officers' degree of agreement on whether or not their clients manage their savings properly, such as saving regularly and in a safe location, which goes a long way in reducing stress in honouring loan engagements. This will show whether these clients have been educated on savings management.	SME
Financial Negotiations Education	Measures the degree of agreement of MFIs credit officers on whether or not their clients have a strong bargaining position vis-à-vis input suppliers, other household members, and financial institution loan	FNE

	terms. This will determine whether or not they are educated on financial negotiation techniques.	
Loan Default Rate	Measures MFIs credit officer's degree of agreement on the rate of loan default.	LD

Source: Authors, from an exhaustive review of empirical literature.

4. Presentation and Discussion of Results

4.1 Presentation of Descriptive Statistics

4.1.1. All Factor loadings for the dependent and independent variables

According to the results presented in Figure 3 below, the factors that did not load well in explaining the variables- money management education (MME), debt management education (DME), savings management education (SME), financial negotiation education (FNE) and loan default rate (LD) were all dropped since they were weak in explaining the variables.

Factor loadings:

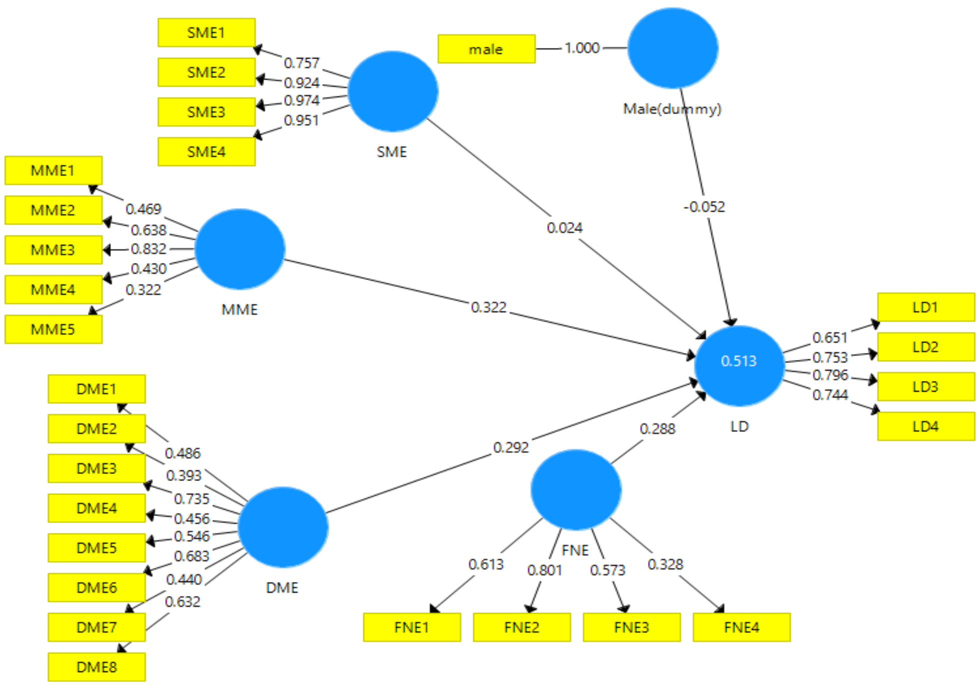


Figure 4.5: Poor Factor Loadings Dropped
Source: Generated by authors using SMART PLS

From Figure 3 above, opinions on the fact that MFIs' clients lack knowledge on how to track cash flows in business with a path coefficient of 0.469, lack knowledge to execute expenditure budgets with a path coefficient of 0.430 and not knowing the benefits of sticking to a spending plan with a path coefficient of 0.322 did not load well on money management education (MME). Considering that the regression coefficients or factor loadings of the aforementioned variables underlying constructs are all less than 0.7

means that these variables did not attain composite reliability and consequently cannot serve well in structural equation modelling. Therefore, these variables are weak in explaining the fact that MFIs' clients lack money management education.

Also, findings from the respondents on factors such as; not enlightening their clients when completing a loan application upon the fact that the loan policy spells out all the procedures involved by MFIs (0.486), assuming that all clients in possession of the loan policy should understand the terms of the loan agreement before contracting a loan by MFIs (0.393), MFIs clients who do not understand the commitment implied by taking a loan (0.456) and MFIs clients who are unable to prepare a debt repayment plan to manage their debt (0.440) have low loadings on debt management education. Therefore, these factors could not explain the fact that MFIs' clients are not educated on debt management knowledge since these variables did not attain the required build reliability coefficient greater than or equal to 0.70, required to achieve construct reliability.

In addition, respondents opinion on whether MFI clients end up complaining of being offered unfavourable loan terms because they had no skills in setting negotiation objectives and sticking to those objectives during negotiations (0.573) and lack of knowledge in setting a negotiation plan and the steps involved in the plan by MFIs clients (0.328) have low loadings on financial negotiations education making this factor not good enough to describe the lack of financial education by MFIs clients. Since these variables did not attain composite reliability of at least 0.7, they were dropped from the structural equation modelling.

4.1.2 Poor Factor loadings dropped for the dependent and independent variables

According to the results presented in Figure 4 below, poor factor loadings were dropped, and only factors that loaded well in explaining the variables money management education (MME), debt management education (DME), savings management education (SME), financial negotiation education (FNE) and loan default rate (LD) were retained since they were strong in explaining the variables.

Factor loadings:

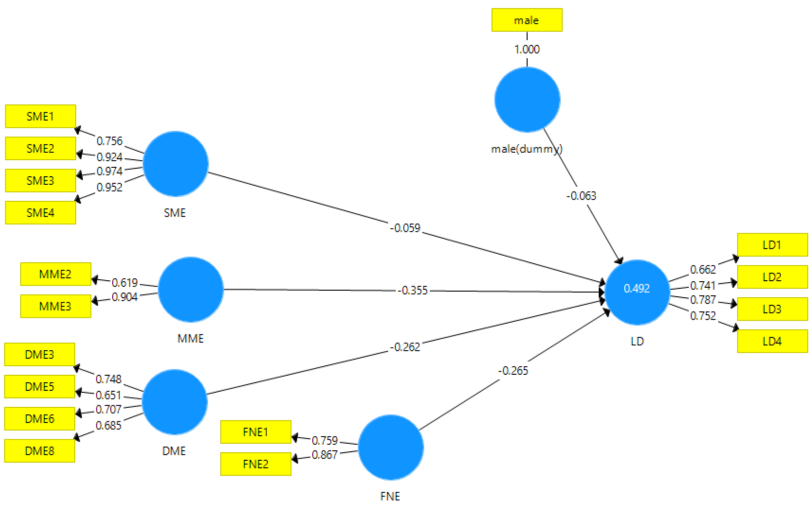


Figure 4: Poor Factor Loadings Dropped
Source: Generated by authors using SMART PLS

The results from Figure 4 show that MFIs' clients submitting cash flow statements during loan request but not knowing the benefits of tracking cash flows in business (0.619) and MFIs' clients who have expenditure budgets in a loan file but do not have the skills to construct an expenditure budget (0.904) have large loadings on money management education. So these factors are strong enough to explain the fact that these clients lack money management education.

Also, the results revealed that opinions on whether MFIs clients; accept loan terms without any knowledge of the implications due to urgent need for money (0.748), do not understand the benefits of timely repayment of their loan instalments (0.651), get involved in excessive debt because they have no knowledge in assessing their repayment capacity (0.707) and are unable to prepare a debt repayment plan that will enable them manage their debt (0.685) have high loadings on debt management education. So, these factors are strong enough to explain the lack of debt management education by MFIs' clients.

Furthermore, it is evident from the results in Figure 4 above that factor loadings on the fact that most MFIs clients; have no skills in preparing a savings plan (0.756), prefer to save a lump sum once a year than to save regularly in smaller amounts even though they have loans (0.924), do not understand the benefits of having a savings plan (0.974) and face the challenge of settling loan instalments because they lack the knowledge on the purpose of savings even though they have regular income sources (0.952), have high loadings on savings management education. This is an indication that these factors strongly predict the fact that these members lack savings management education.

In addition, findings on whether most MFIs' clients negotiate loan terms without understanding the principles of negotiation (0.759) and do not know the techniques of negotiation, thus making them unable to negotiate for what they want during a loan request (0.867), loaded well in explaining financial negotiations education. So these factors have a strong bearing on the fact that MFIs do not have financial negotiations knowledge.

Lastly, factor loadings on the fact that MFIs have witnessed; an increase in portfolio at risk >30 days and > 90 days (0.662), increased number and proportion of borrowers with delayed repayment (0.741); compare clients with and without financial education, increased number and proportion of borrowers in arrears >30 days and > 90 days (0.787); compare clients with and without financial education, a general increase in default rate both in terms of loan principal and interest (0.752) loaded largely on loan default rate. This therefore shows that these factors strongly indicate that loan default rate in the MFIs under study has increased.

4.1.3 Path Coefficients

Table 5: Effects of Financial Education on Loan Default

	Original Sample	Sample Mean (...	Standard Deviation	T Statistics (/O/...	P Values
DME ->LD	-0.267	-0.277	0.157	1.698	0.090
FNE ->LD	-0.261	-0.264	0.157	1.662	0.097
MME ->LD	-0.357	-0.348	0.099	3.593	0.000
SME ->LD	-0.051	-0.066	0.107	0.476	0.635
Male(dummy)	-0.064	-0.069	0.107	0.595	0.552

Source: *Generated by authors using SMART PLS*

Results based on Table 5 above show that DME affects LD positively and significantly at 10%. Specifically, an increase in the absence of debt management education in MFIs' clients is expected to increase the loan default rate significantly. This could mean that the current state of DME in MFIs is not sufficient to drive a reduction in LD. Also, the results above show that FNE positively and significantly affects LD at 10%. Therefore, an increase in the absence of financial negotiations education in MFIs' clients is expected to increase the loan default rate significantly. This means that the present state of financial negotiations education is not sufficient to drive a reduction in the loan default rate.

In addition, the results above indicate that MME affects loan default rate (LD) positively and significantly at 5%. Specifically, an increase in the lack of money management education among MFIs' clients is expected to increase the loan default rate significantly by 5%.

Lastly, the findings above show that SME positively but insignificantly affects LD at 10%. Therefore, any improvement in the level of savings management education by MFI clients will improve the loan default rate insignificantly.

Table 6: SEM R-Squared of Latent Variables

	R Square	R Square Adjusted
LD	0.492	0.435

Source: *Generated by authors using SMART PLS*

The results in Table 6 above show that money management education (MME), debt management education (DME), savings management education (SME) and financial negotiations education can determine up to 49.2% of the variation in loan default rate, given a coefficient of determination of 0.492, which is significant at 5%. This means that if the loan default rate in MFIs increases by 100%, the fact that MFIs' clients lack money management education, debt management education, savings management education and financial negotiations education has contributed 49.2% of this increase. This result leads us to reject the null hypothesis and conclude that financial education of clients has a significant impact on the loan default rate of microfinance institutions in Cameroon.

4.1.4 The test for multicollinearity

Table 6 below presents the test for multicollinearity using Pairwise correlations.

Table 7: Pairwise correlations

	DME	FNE	LD	MME	SME	Male(dummy)
DME	1.000	0.469	-0.548	0.358	0.270	0.296
FNE	0.469	1.000	-0.469	0.212	0.145	-0.037
LD	-0.548	-0.469	1000	-0.541	-0.365	-0.180
MME	0.358	0.212	-0.541	1.000	0.513	0.102
SME	0.270	0.145	-0.365	0.513	1.000	0.242
Male(dummy)	0.296	-0.037	-0.180	0.102	0.242	1.000

Source: Generated by authors using SMART PLS

Here, the results show that there was no evidence of strong correlation between independent variables, so no potential multicollinearity problem.

4.2 Discussion of the Results

The results according to Table 5 above show that a unit increase in the absence of debt management education in MFIs clients is expected to increase the loan default rate significantly by 1.698 units. Therefore, without proper education, MFIs' clients will not be able to manage their debts, thus increasing loan defaults. This finding ties to an extent (because the variables are different from those of this study) with the findings of Bichanga (2013) who studied the causes of loan default within micro finance institutions in Trans Nzoia County, Kenya and found that loan default was cause by non-supervision of borrowers by the MFIs, and also as a result of inadequate training of borrowers on the utilization of loan funds before they received loans.

Also, the results above show that FNE positively and significantly affects LD at a 10% level. Therefore, a unit increase in the absence of financial negotiations education in MFIs clients is expected to increase the loan default rate significantly by 1.662 units. This means that the present state of financial negotiations education is not sufficient to drive a reduction in the loan default rate.

In addition, the results above indicate that money management education affects loan default significantly at the 5% level. Specifically, a unit increase in the lack of money management education of MFIs' clients is expected to increase the loan default rate significantly by 3.593 units. This finding is in accordance with that of Lucia et al. (2021), who used a randomised controlled trial to evaluate the outcome of integrating money management and entrepreneurial training into a microcredit program in India. The results equally show that money management education (MME), debt management education (DME), savings management education (SME) and financial negotiations education (FNE) can determine up to 49.2% of the variation in loan default rate, given a coefficient of determination of 0.492, which is significant at 5%. The results of this study are in line with the study conducted by Jalaludeen. (2018), who studied targeted sensitisation as a strategy to reducing loan default in microfinance bank operations in Yola, Adamawa State, Nigeria and found that targeted sensitisation programs affect microfinance bank default rates. This study has underscored the importance of targeted sensitisation as an important strategy in reducing loan defaults in microfinance operations.

5. Conclusion and Recommendations

The study set out to investigate the effects of customers' financial education on loan default rate in microfinance institutions in the North West Region of Cameroon. The results show that Microfinance Institution exercises a less than sufficient avenues to educate customers on financial principles guiding the loan granting process. The only period used to educate customers is during annual meetings that take place once a year, and very little time is allocated for customer education, resulting in financier electracy. To be more precise, it was revealed that most MFIs' clients lack money management, debt management, savings management and financial negotiations, which have increased the loan default rate in these microfinance institutions. This, therefore, makes us conclude that customer financial education has an effect on the loan default rate of MFIs in Cameroon. This result is a clear indication that if these MFIs invest more in educating their clients on money management skills, debt management skills, savings management skills and financial negotiation skills, the loan default rate of these institutions will decrease.

The study recommends that the management of MFIs should utilise all avenues available to educate their clients rather than limiting financial education only during general education meetings.

The study also recommends that MFIs in Cameroon should invest in the education of their clients on how to manage their money, manage their debts, manage their savings, carry out financial negotiations and use the different financial services available to them, as this will go a long way to increase their ability to handle their financial obligations. In addition, the study recommends that MFIs should not limit education to the services offered by these institutions but should, from time to time, offer training to these clients on how to manage the money borrowed in their respective businesses to ensure these businesses make profits that will enable them to handle their loan obligations in a timely.

The study further recommends that during loan appraisals, microfinance institutions should enlighten their clients on the implications of lead time on the loan granting process and disbursement of loans since this also affects the client's ability to repay.

of the study as it could not include other MFIs in remote areas severely affected by the crisis.

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