Financial Capability Surveys Around the World

Why Financial Capability is important and how surveys can help

KEY MESSAGES

- *Financial capability is the internal capacity to act in one's best financial interest, given socioeconomic and environmental conditions. It encompasses the knowledge (literacy), attitudes, skills, and behavior of consumers with respect to understanding, selecting and using financial services, and the ability to access financial services that fit their needs.*[1]
- *Financial capability can be measured by assessing people's financial knowledge, skills, attitudes, and behaviors. Based on these measurements, meaningful indicators can be developed to effectively inform policy objectives.*
- *Policymakers are increasingly using surveys as diagnostic tools to inform the design of national strategies in order to improve people's financial capabilities, inclusion, and consumer protection.*
- *Surveys can be used to identify areas of financial capability, inclusion, and consumer protection that need improvement; assess knowledge and actions linked to policies and regulations; and to target potential demographic groups.*

INTRODUCTION

Financial capability is increasingly becoming a priority for policymakers in both high income and emerging economies, as it is recognized as contributing to financial stability, financial inclusion, and to the effective functioning of financial markets. Today, people are required to take increasing responsibility for managing a variety of risks over the life cycle. People who make good financial decisions and interact effectively with providers of financial services, therefore, are more likely to achieve their financial goals, improve their household's welfare, hedge against financial risks and negative shocks, and support economic growth.

> ***Financial capability** is the internal capacity to act in one's best financial interest, given socio-economic environmental conditions. It encompasses the knowledge (literacy), attitudes, skills and behaviors of consumers with regard to managing their resources, and understanding, selecting, and making use of financial services that fit their needs.*

Improving financial capability has thus emerged as a strategic policy objective that complements governments' financial inclusion and consumer protection agendas. To this end, policymakers are increasingly using surveys as diagnostic tools to identify key problem areas and inform the design of national strategies. According to the OECD (Grifoni and Messy 2012), at least 36 countries have established or are in the process of designing a national strategy for financial education. Moreover, 80 percent of these countries have used a survey as a diagnostic method to identify the key priorities for their national strategies. In general, surveys of financial capability seek to achieve the following objectives:

- Create a baseline assessment of weak areas of capability/identify target populations
- Identify potential channels for delivering information and financial education
- Understand the relationship between financial knowledge/literacy and behavior
- Understand individual behavior with respect to personal or household finances

[1] The terms financial literacy and financial capability are often used interchangeably. The term financial literacy is often associated with financial knowledge. Financial capability is a broader term, also encompassing behavior and the interaction of knowledge, skills and attitudes.

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By identifying and analyzing existing surveys, this note outlines and compares key approaches to measuring financial capability and the external factors that may affect it, offering policy makers a broad range of options to consider when developing their research and policy objectives. The topics reviewed here are covered in depth in Making Sense of Financial Capability Surveys around the World: A Review of Existing Financial Capability and Literacy Measurement Instruments.[2]

HOW CAN FINANCIAL CAPABILITY BE MEASURED?

Financial capability encompasses the knowledge, attitudes, skills, and behaviors of individuals with regard to managing their financial resources and understanding, selecting, and making use of financial services that fit their needs. Surveys of financial capability can measure some observable aspects of this internal capacity, as well as the interaction between internal capacity and the enabling environment. External factors that can affect how internal capacity manifests itself into actual behaviors include financial resources, access to finance, social norms and obligations, financial infrastructure, and existing financial consumer protection mechanisms. Given its multidimensional nature, it is difficult to measure financial capability with a single indicator, and financial capability surveys usually measure the following broad concepts:

Since the relative importance of the various aspects of capability may depend on the context being studied, not all of these concepts are measured in all surveys of financial capability. For instance, evidence from the World Bank's research initiatives supported by the Russia Financial Literacy and Education Trust Fund (WB/Russia Trust Fund) shows that knowledge of financial products is not as relevant in indicating financial capability in developing countries as it is in more developed economies, which may be linked with lower levels of access to financial services (Kempson et al 2013).

Measuring Financial Literacy

One aspect of financial capability that is often measured is financial literacy or knowledge. For surveys of financial knowledge, this means identifying specific knowledge gaps and potential target population groups for financial education programs. In general, studies of financial literacy measure the following three concepts:

1. Knowledge of fundamental financial concepts;
2. Awareness of products and services offered by different financial service providers and an understanding of the risks associated with using these products and services; and
3. Understanding how to manage personal finances or use financial services.

Studies that assess people's knowledge of financial concepts generally look at key economic concepts deemed important for navigating the formal economy, including inflation, interest rates, risk diversification, and taxation.

Financial Capability Concepts

Knowledge	Skills	Attitudes	Behaviors
■ Knowledge of financial concepts (inflation, compound interest etc.) ■ Awareness of financial products and services ■ Practical Know-how (how to make payments, how to open a bank account etc.	■ Numeracy Skills ■ Literacy Skills	■ Reasons for or for not saving, borrowing, investing, etc. ■ Attitudes Towards the future ■ Confidence in own plans for old age ■ Proclivity towards budgeting, saving, lending etc.	■ Money management (managing day-to-day finances). ■ Long-term planning (preparing for emergencies and retirement) ■ Financial decision-making (ability to choose appropriate financial products) ■ Seeking financial advice.

[2] Available Online at: http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Misc/Financial-Capability-Review.pdf

For example, the 2004 U.S. Health and Retirement Study (HRS), asks respondents:

> *Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account?*
>
> *1- More than today 2- Exactly the same 3- Less than today 4- Do not know 5- Refuse to Answer*

Given the number and complexity of financial products in the market today, measuring people's awareness of financial services and products can help evaluate their understanding of the functions of financial service providers and their knowledge of the risk and advantages associated with financial products and services. The module on financial capability used in the US Survey of Consumers 2001 includes a number of true or false questions that test respondents' knowledge on the functions of financial service providers. For instance, the module asks questions regarding whether the bank is responsible for informing a consumer of an impending overdraft and whether credit repair agencies can remove negative credit information. Similarly, the Financial Literacy Survey conducted in Portugal asks respondents about the minimum deposit required to access bank services and it tests their knowledge of Internet banking.

Studies can also measure consumers' knowledge about the use of financial products and management of personal resources, including how to save, borrow, invest, and protect oneself against financial fraud. An important concept that these surveys measure is whether respondents know their consumer rights and know how to seek recourse for unfair financial practices or fraud.

Evaluating Skills

Evaluating people's cognitive skills, such as basic numeracy and literacy skills, can also support the measurement of financial capability. The measurement of skills sheds light on the potential limitations to the proper use of financial products and services. Accordingly, a number of studies gather data on respondents' skills in addition to assessing levels of financial knowledge.

Literacy skills are usually measured at the beginning of a survey in order to gauge whether respondents can understand official communications in the main language spoken in the country. These are usually followed by questions designed to test numeracy skills. Surveys test financial literacy by focusing on the ability to make simple calculations connected to basic economic concepts. For example, the Kenya FinAccess survey includes questions on numeracy skills:

> You have a lot of mangoes on your farm and your neighbor has lots of tomatoes. You make a bargain and he says he will give you three tomatoes for every mango you give him. If you give him fourteen mangoes, how many tomatoes do you expect him to give back to you?

Measuring Attitudes

Personal views, beliefs, or psychological traits can affect people's financial decision-making and consequently form a part of their internal financial capability. Accordingly, some financial capability surveys include questions designed to measure psychological characteristics, such as attitudes and motivations. Studies like the Singapore National Financial Literacy survey, FinAccess, the Special Eurobarometer 230, and the WB/Russia Trust Fund survey include examples of questions on attitudes.

A number of studies focus on motivations for financial behavior using scales developed in psychological research or simply by inquiring about the reasons for adopting certain kinds of behavior. These surveys ask about reasons for saving, borrowing, long-term planning, and budgeting, among other indicators. The WB/Russia Trust Fund survey, for example, contains a set of questions that measure impulsiveness, attitudes toward the future, and achievement orientation. Other studies, like the Singapore National Financial Literacy survey, FinAccess, and the Special Eurobarometer 230 include questions about preferences toward or reasons for long-term planning, lending, saving, and day-to-day money management.

Attitudes can also be measured by assessing people's proclivity toward certain types of behavior. These studies look at people's tendencies to choose between financial products, prepare for emergencies and manage risk, and save, invest, and borrow. A financial capability study conducted in Fiji, the "Financial Capability, Financial Competence, and Wellbeing in Rural Fijian Households" study, includes a number of questions regarding people's attitudes towards the future and money management (e.g. impulse purchases, saving versus spending). For instance, the survey asks respondents:

> *I will now read out a number of statements. I would like you to tell me how much you agree or disagree with the following statements:*
>
> *"I do not worry about the future and let tomorrow take care of itself."*
>
> *"It is hard for me to pass up a bargain."*
>
> *"I find it more satisfying to spend money than to save it for the long term."*

Measuring Financial Behavior

Often financial capability is expressed and measured in terms of behaviors that result from the interaction of internal capabilities and external factors. In surveys that measure financial behavior, the objective is to identify weak areas of behavior and the least capable subgroups of the population. The types of financial behavior that are measured by surveys can usually be classified into four main areas: money management (managing day-to-day finances), long-term planning (preparing for emergencies and retirement), selecting financial products (ability to choose appropriate financial products), and seeking advice.

Survey questions about money management generally focus on people's ability to budget and spend within their disposable income, pay bills, borrow within affordable limits, and use and manage their bank accounts. In order to measure people's long-term planning behavior, surveys ask respondents about their savings behavior, including the frequency of savings, how they would adjust in case of an unexpected drop in income, and whether they have made any pension provisions or other plans for old age and other types of insurance.

The Financial Diaries study presents a unique approach to measuring financial behavior by assessing poor households' money management and long-term planning decisions on a daily basis over an extended period of time. The study gathers information on how families living on less than $2 US dollars a day in South Africa, Bangladesh, and India manage their cash flow, plan ahead, borrow and lend money, and manage emergencies.

Likewise, but on a less detailed level, studies like the World Bank Financial Capability and Consumer Protection survey (WB FCCP), the UK FSA study, the WB/Russia Trust Fund survey[3], and the Portugal Financial literacy survey measure dimensions of money management and long-term planning. The U.K. "Measuring Financial Capability: An Exploratory Study," for example, is concerned with more general aspects of financial behavior, such as making a budget, planning ahead, or dealing with unexpected expenses (Kempson et al., 2005). The survey asks:

> *When you receive money, do you plan how it will be used?*
>
> *1. Yes*
>
> *2. No*

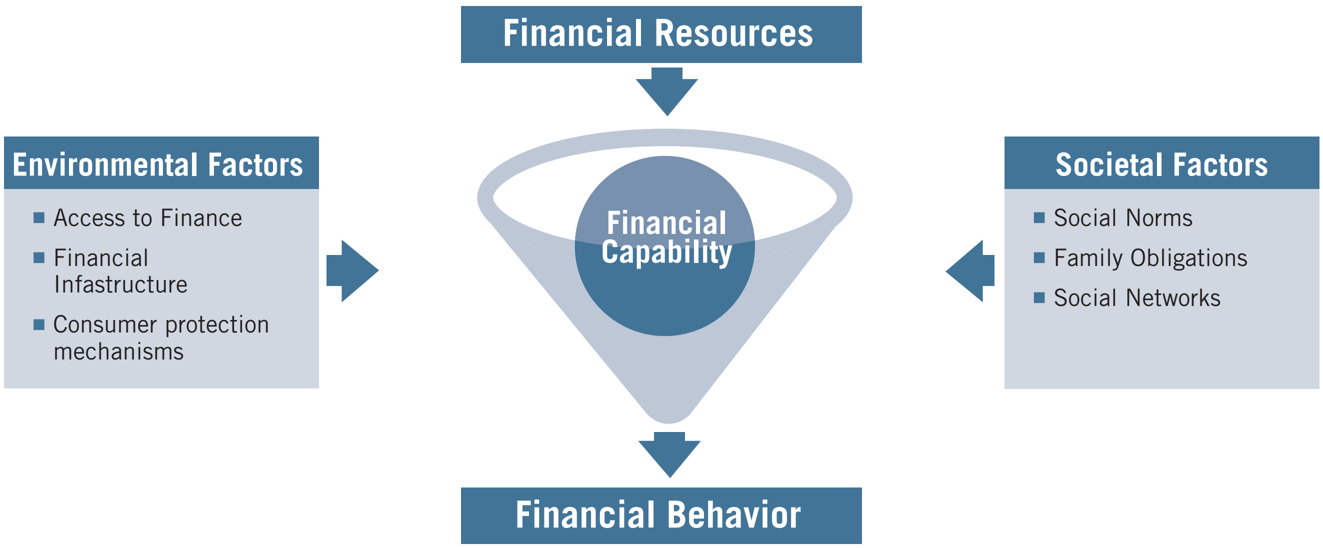
In addition, this and other studies gathered important data on what products respondents purchased, how they made financial decisions, and how they stayed informed on financial matters.

MEASURING EXTERNAL FACTORS THAT AFFECT FINANCIAL CAPABILITY

Financial capability means that individuals have the internal capacity to act in their best financial interest, given socioeconomic and environmental conditions, which can play an important role in constraining or facilitating individual financial capability. Policy makers have

[3] The WB FCCP Survey is essentially the same as the WB/Russia Trust Fund survey, but with questions added on financial inclusion and financial consumer protection in order to ensure a better understanding of the importance of external factors on financial capability.

FIGURE 1: EXTERNAL ENVIRONMENT AND FINANCIAL CAPABILITY



increasingly used surveys to understand the importance of external factors on financial capability. External factors may include societal factors, like family demands or social networks, and environmental factors, like access to financial products, financial infrastructure, and consumer protection mechanisms. In Papua New Guinea, for example, the *wantok* system is an unwritten social contract that serves as a safety net, in which people of the same village or town are obligated to help those who are in poor financial condition.

Financial inclusion surveys can assess both access and usage of financial services. They typically include an assessment of barriers to access and usage. Constraints to accessing financial services can include: documentation requirements, physical distance of providers' premises, and cost. Usage can be measured by assessing the regularity, frequency, and duration of use of financial products and services. Surveys such as the World Bank's Global Findex, FinScope, and FinAccess provide internationally comparable data on financial inclusion.

Financial consumer protection complements financial inclusion and financial capability, in ensuring that financial markets are both inclusive and stable. Financial consumer protection is a particular priority when users (or potential users) of financial products do not have the necessary knowledge, skills, or attitudes to protect themselves

MORE INFORMATION & RESOURCES

World Bank. 2013. "Making Sense of Financial Capability Surveys around the World: A Review of Existing Financial Capability and Literacy Measurement Instruments." World Bank, Washington, DC. Available at: http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Misc/Financial-Capability-Review.pdf

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from the risks derived from interaction with providers of financial services. Surveys of financial consumer protection, therefore, can also seek to measure awareness and knowledge of consumer protection mechanisms, use of dispute resolution mechanisms and actions in reporting fraud or conflict with providers, and perceptions of government regulatory bodies and financial service providers. Assessing consumer experiences with financial crime is another important, though less common, purpose for some financial consumer protection surveys. The World Bank's FCCP survey, for example, captures specific information on the level of people's satisfaction with services offered by financial institutions and government institutions. The FCCP survey collects data on the level of trust people have in regulatory and supervisory institutions and their confidence in resolving conflicts with financial service providers.

HOW TO DEVELOP MEANINGFUL INDICATORS THAT CAN INFORM POLICY?

In order to effectively inform policy objectives, data collected through surveys must be properly analyzed and interpreted. A good starting point for developing indicators is to report frequencies and proportions of people who answer individual questions in a specific way. The main advantage of this approach is that no specific statistical knowledge is needed to either analyze data or understand the results.

Single questions alone, however, cannot provide a complete picture of the topics that interest policy makers. Therefore, it is necessary to develop composite scores or indices. For instance, if policy makers want to assess people's financial knowledge, they could create a simple score which sums up the number of correct answers to quiz-like financial knowledge questions. Due to the multifaceted nature of some topics, it might not always be meaningful to construct a single composite score or index though. This is particularly relevant for studying financial capability data not only in terms of financial knowledge, but also as a combination of behaviors, skills, attitudes. Information at the level of specific indicators can also be more useful for formulating actionable policy recommendations. For instance, a single financial capability score could provide a general assessment of the level of capability, but it would not help to inform the

SURVEYS

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design of specific policies to improve people's financial capabilities. Having scores for different aspects of financial capability, such as budgeting, saving, or planning for old age expenses, allows policy makers to specifically address weak areas by designing targeted programs.

Table 1 lists indicators generated by the World Bank and OECD/INFE surveys, that can inform and guide policymakers. These survey models can be used and tailored by individual countries and agencies.

Identifying Target Groups

The simplest way to identify vulnerable groups of the population for which targeted interventions can be designed is to use cross-tabulations, in which indicators are calculated by key demographic variables (such as age, gender, education, employment status, and income). Regression techniques can improve understanding of the relationship between socio-demographic characteristics and financial capability indicators. Segmenting the population is another approach that can be used to identify target groups. The simplest way to do so is to rank people according to their scores and to build equally sized groups. Cluster analysis is a more sophisticated statistical technique that can be used to segment populations across multiple scores and to identify groups that show similarities in their scores.[4]

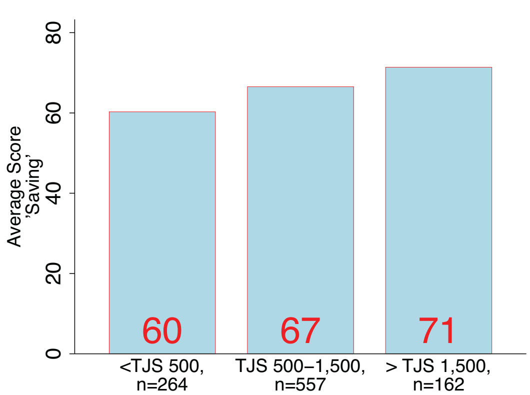
Selecting the most effective Policies and Interventions

Baseline survey data can help to identify potentially useful areas of interventions and to select the type of intervention to implement. To properly address the question of which type of intervention works best, rigorous impact evaluations are ideally required. For example, if policymakers want to determine whether school-based financial education

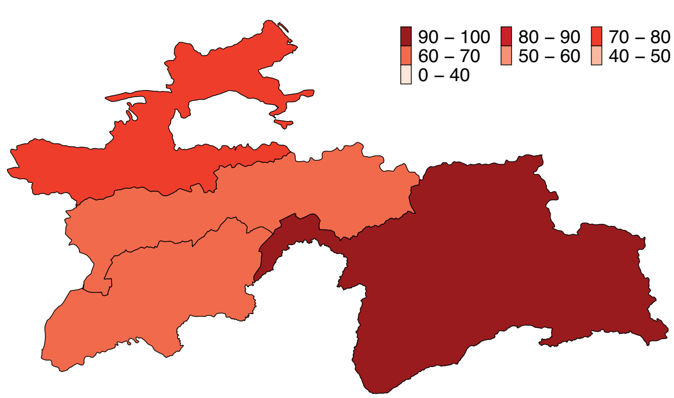
BOX 2: PRESENTING INDICATORS AND IDENTIFYING TARGET GROUPS

Cross tabulations are usually presented in a table. Charts and graphical representations such as maps are widely used and effective tools to present indicators and to identify target groups. For instance, the bar chart below shows the average financial capability score for saving for different income groups in Tajikistan. As can be seen, income matters, and low income groups seem to struggle more with building savings cushions than those who live on the highest incomes. The map below illustrates spatial differences in the savings score with residents living in eastern parts of Tajikistan being more inclined to put money aside than those who live in any other regions of the country.

AVERAGE FINANCIAL CAPABILITY SCORE 'SAVING', BY MONTHLY HOUSEHOLD INCOME.



AVERAGE FINANCIAL CAPABILITY SCORE 'SAVING', IN DIFFERENT REGIONS.



Source: World Bank 2013

[4] For more guidance, see Everitt, S. Brian, Landau, Sabine, Leese, Morven, and Daniel Stahl. 2011. "Cluster Analysis." 5th Edition. John Wiley & Sons, Ltd, Chichester, UK.

or comic books would be an effective way to deliver financial messages on money management to younger populations, an impact assessment would be necessary. Robust evidence on which approaches are the most effective in delivering financial education or supporting beneficial financial inclusion is still limited. The WB/Russia Trust Fund has therefore supported a comprehensive set of impact evaluation studies to assess the efficacy of a wide range of financial capability programs in different settings. Insights and findings for these projects, as well as an Evaluation Toolkit focusing on the specific challenges of evaluating financial capability interventions in low- and middle-income environments, are available on the World Bank Group website on Financial Consumer Protection and Financial Capability (http://responsiblefinance.worldbank.org).

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TABLE 1: INDICATORS FOR FINANCIAL CAPABILITY

CATEGORY	DESCRIPTION	SURVEY
FINANCIAL KNOWLEDGE AND SKILLS	1. **Financial knowledge score** (based on knowledge of basic financial concepts such as inflation, simple interest, compound interest, money illusion, risk diversification, and main purpose of insurance policies)	WB FCCP, OECD/INFE Financial Literacy Survey
FINANCIAL BEHAVIOR	1. **Budgeting score** (based on whether adults plan how to use money they receive, in terms of frequency, accuracy and regularity with which they stick to the plan) 2. **Not overspending score** (based on spending money on unnecessary things before buying food and essentials, and spending on non-essentials adults cannot afford) 3. **Living within means score** (based on whether adults run short of money after buying essentials and why, their level of borrowing, and if they borrow to buy food and other essentials) 4. **Monitoring expenses score** (based on whether adults know how much money they spent in the last week, and how much they have available to spend) 5. **Savings score** (based on whether adults try to save for the future, try to save for emergencies, and try to save even if a small amount) 6. **Planning for old age expenses score** (based on whether adults have strategies in place which allow to cover expenses in old age) 7. **Planning for unexpected expenses score** (based on whether adults could cover an unexpected expense equivalent to a month's income, and if not whether they worry about it)	WB FCCP, WB/Russia Trust Fund survey
ATTITUDES	1. **Attitudes towards the future score** (based on agreement with statements about living more for the present day than for tomorrow, the future will take care of itself, focus on the short term) 2. **Non-impulsiveness score** (based on agreement with statements about being impulsive, saying things without giving them too much thought, doing things without thinking them through) 3. **Achievement orientation score** (based on agreement with statements about having inspirations, working hard to be the best, always looking for opportunities to improve one's own situation)	WB FCCP, WB/Russia Trust Fund survey