Financial Capability, Financial Competence and Wellbeing in Rural Fijian Households

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PACIFIC FINANCIAL INCLUSION PROGRAM (PFIP)

Executive Summary

Overview of the Study

This study has sought to increase our understanding of the relationship between financial competence and household wellbeing in rural communities in the Pacific, in particular to examine whether there is a positive relationship between financial knowledge and skill, financial behaviour and attitude to money of those who make financial decisions on behalf of the household and the wellbeing of the household generally.

Financial inclusion in rural communities has become the focus of increased attention in recent years. There has been a number of financial literacy training programs and efforts to enhance participation in the formal financial sector by rural households. However, we know little about levels of financial literacy and patterns of financial behaviour in rural communities, in particular communities transitioning from subsistence lifestyles to monetised lifestyles; we know little about attitudes to money held by people for whom engagement with the money economy is not a core component of their daily life; and we know little about the relationship between financial behaviour and household wellbeing in these communities.

The study has sought to develop a comprehensive understanding of the ways in which rural Fijian villagers use money and access the formal financial system; and the nature of the relationship between rural villagers' levels of financial competence and the wellbeing of their households.

The study has used the lens of financial competence. The literature examining the relationship between the ability to manage money and the impact this has on wellbeing is fragmented and has tended to focus on disadvantaged households in highly urbanised environments. In order to develop a comprehensive understanding of rural villagers' ability to manage money, to interact with the formal financial system, and the relationship between these activities and their wellbeing, villagers' financial competence has been assessed. Competence is a well developed construct in the skills training, professional training, educational and legal literatures. Financial competence encompasses a range of money related activities and includes planning and prioritising short and longer term spending, savings, investment, the management of credit, the management of cash flows and budgeting, and the management and enhancement of income generation.

Financial competence is rapidly increasing in importance for rural households across the Pacific. Subsistence lifestyles are becoming progressively monetised. Even at the most basic level, households must fund children's education and family medical expenses. Increasing electrification and consumerism bring an increased imperative to engage successfully with the money economy. In addition there is increasing interaction and interchange between rural and urban households across the Pacific. As urbanisation increases there is a concurrent increased reliance on wage and salary employment. In several Pacific Island States, domestic and international remittances now play an important role in providing a significant component of household cash inflows.

Increased engagement with the money economy generates an increased requirement to engage with the formal financial sector. Households must be able to access the payments system, to keep surplus cash safe and accessible, and to access affordable and reliable credit services. Unfortunately increasing monetisation also brings increased exposure to ever more sophisticated financial scams. Household's which cannot differentiate between legitimate and fraudulent financial opportunities are very vulnerable.

The study has sought to determine whether participation in a program to increase financial literacy and to provide access to reliable banking services can increase financial competence, in particular whether rural villagers who participated in the program demonstrate an enhanced ability to manage their household's finances, and consequently whether their households enjoy better wellbeing.

The study has used case methodology and has examined the impact of an initiative to increase rural Fijian villagers' engagement with the formal financial system. The initiative comprised two discrete but related elements: Firstly, a rural financial literacy program developed and deployed by the UNDP Pacific Centre in conjunction with the National Centre for Small and Micro Enterprise Development (NCSMED) and secondly, the concurrent and linked development by ANZ Bank of a mobile vehicular banking service for rural villagers. The initiative commenced late 2004. Full roll-out occurred during 2005. Data was collected from structured interviews with 400 adults from 200 households in fourteen villages in Naitasiri Province, Viti Levu. The study also refers to a related study of a similar size, which examined the financial competence of rural villagers in Guadalcanal, Solomon Islands.

The study was sponsored by UNDP Pacific Centre, Fiji and overseen by Massey University, New Zealand.

Key Findings

The study has found a positive relationship between financial competence and household wellbeing in rural households.

Households in which the principal financial decision makers are financially competent are more likely to manage household cash flows and to use a budget to plan future expenditure. These households are more conservative in estimating household expenditure and household income, including income from farming and businesses owned by the household. As a consequence these households are more likely to have a cash surplus at the end of their payment cycle and to re-invest cash in the farm or business to further enhance income. Households in which the principal financial decision makers are financially competent are more likely to save money regularly and to use a bank account for saving.

By contrast, households in which the principal financial decision makers are less financially competent tend to under-estimate household expenditure and to over-estimate household income. These households are less likely to manage household cash flows and to use a budget to plan future expenditure. In addition, households in which the principal financial decision makers are not financially competent are less likely to have family businesses to augment farming income. Importantly these households are less likely to have surplus cash at the end of their payment cycle and are more likely to resort to the use of store credit to purchase food and other household consumables; and to use hire purchase for household durables. Consequently they are less likely to re-invest cash in the farm or business.

Rural Financial Services Initiative

The study has found the Rural Financial Services Initiative was successfully implemented and provides a useful model for similar capability development initiatives. A key element of the success of the initiative was the (tacit) use of competency as a basis for the development of the Initiative. Importantly, it is evident from both the Fiji Financial Capability Initiative and the Solomon Islands Financial Capability Initiative that financial competence can be enhanced by an appropriately structured intervention.

The Rural Financial Services Initiative was developed following the determination of demand by rural villagers for enhanced access to the banking system in Fiji. The combination of training and access to banking was, in effect, a competency development program grounded in experiential learning:

- Villagers' financial knowledge and skill was enhanced and villagers were concurrently provided with the opportunity to enact that knowledge (directly and indirectly) through the use of a savings account in order to facilitate better household cash flow management.
- Most villagers were able to use the training immediately. There was therefore a low risk of erosion of knowledge due to inability to apply knowledge in context.
- The Rural Banking Service was explicitly structured to reduce risk. Perhaps most importantly neither the bank, nor the banking system generally, was required to assume new or expanded risk, beyond that of existing day-day operations:
  - Risk to capital: The use of leased structures, combined with the tax subsidy and depreciation allowances enabled the Bank to initiate the Rural Banking Service with a low risk to capital.
  - Risk to profit: The focus on deposits enabled rapid cost recovery, which when combined with the tax subsidy and depreciation, minimise the loss from the provision of the Rural Banking Service in the early years.
- The use of a modular organisational structure enabled public and private providers to work together in circumstances in which the divergent requirements of each organisation could co-exist.

The Relationship between Functional Literacy and Financial Competence

The study has found household's in which the principal financial decision makers are more highly educated are typically more functionally literate and are more likely to have higher financial knowledge and skill and to adopt more positive financial behaviours. These households are more likely to attend Financial Literacy Training and to open a Rural Savings Account. They are less likely to resort to the use of credit for daily needs and if they borrow, are more likely to borrow for investment purposes. Their households typically have a higher level of household wellbeing. The relationship between level of education and household assets found in earlier studies was also found in the present study.

The Relationship between Financial Competence and Household Wellbeing

The study has found there is a positive relationship between villagers' financial competence and the wellbeing of their households. In general terms (and at the risk of appearing overly simplistic and gender-bound) the wellbeing of rural Fijian households in Naitasiri Province is based on the husband's ability to generate agricultural income (augmented by small business income generated by the wife) and the wife's ability to manage the household cash flows.

The relationship between level of education, financial literacy and financial participation found in earlier studies was also found in the present study. The relationship between participation in the formal financial system and household wellbeing found in earlier studies was found in the present study.

The elements that separate households in rural Naitasiri are not the size of the plots farmed, the size of the family or the size of the household, but the ability of the household to re-invest surplus in further income generation and to manage household expenditure prudently. There is evidence that households which are better able to do this (households which are more financially competent) enjoy a better standard of household wellbeing than those which do not develop the household's ability to generate income or manage the household cash-flows using a budget and a bank account.

Households which are less financially competent tend to over-estimate cash available for discretionary spending due to overestimation of household income and under-estimation of household expenditure. The lower level of household budgeting by these households would appear to be a significant factor. Importantly, households which evidence a lower level of financial competence estimate an inverse relationship between their household income and expenditure. Rather than estimating higher levels of expenditure as income increases, households which have lower financially literate estimate lower levels of household spending.

Households which participated in the Rural Financial Services Initiative (in particular households which participated in both the Financial Literacy Training Workshop and the Rural Banking Service) appear to have already been more financially competent and more affluent (measured in terms of household durables) than households which did not participate in either element of the financial capability initiative. Households which participated in the Rural Financial Services Initiative evidence greater financial competence across a range of aspects of the management of agricultural, business and household cash flows. Importantly, we can attribute knowledge of, and the use of, budgeting to participation in the Financial Literacy Training Workshop, in addition of course, to access to the banking system.

It is reasonable to conclude that villagers who participated in the Rural Financial Services Initiative did so primarily to re-enforce and enhance existing positive financial behaviours by increasing the household's financial knowledge and to access the formal banking system (which had previously been very difficult to access). The Rural Financial Services Initiative has therefore enhanced participants' knowledge of budgeting (and within this context household cash flow management generally) and has facilitated enhanced financial behaviour in respect to both budgeting and the use of a bank account for safe custody. Villagers who have opened a Rural Savings Account consider they have derived a greater range of financial goal related benefits than anticipated prior to opening the Account.

Villagers who did not participate in the Workshop and/or do not have a Rural Savings Account evidence a lower level of financial competence, in respect to both financial knowledge and skill and financial behaviour.

Policy and Strategy Recommendations

It is evident rural Fijian villagers are engaging with the money economy and are using a broad range of financial services. It is likely villagers' use of financial services will increase in the medium term and with this the need for a heightened level of financial sophistication will also increase. Arguably, Pacific Island States are at a 'tipping point' in respect to rural financial inclusion. To date, due to the prevalence of subsistence farming in the Pacific there has not been a significant requirement for rural Pacific Island communities to engage with the money economy. However, the money economy is rapidly becoming more pervasive and rural villagers are not immune from the need to participate in the formal financial system.

Enhancing financial capability leads to enhanced financial competence and, in turn, facilitates increased household wellbeing. Financial competence can be enhanced by an appropriately structured financial capability initiative. Functional Literacy is, however, an important pre-condition.

If little is done to facilitate rural villagers' engagement with the formal financial system there is a very real possibility that levels of alienation will rapidly rise as the requirement to be able to use money and the formal financial system increases.

Alienation from the money economy reduces peoples' ability to enhance their wellbeing. It also brings a greater risk of financial exploitation as people seek informal sources of credit in order to cover cash shortfalls. Currently villagers who experience a cash shortfall use store-credit to smooth cash flows. However, as urbanization increases, opportunities to access store credit will reduce and will be replaced by greater reliance on the pernicious urban equivalent: pay-day lending.

There appear to be signs of this emerging in the present study. Villagers who are financially competent have tended to take the opportunity to enhance their financial knowledge and skill (and in doing so have enhanced the management of household cash flows through better household cash management practices) and have opened bank accounts in order to better manage household cash and to provide for future spending requirements. Villagers who are less financially competent have tended not to take the opportunity and appear to be falling behind, both in terms of financial knowledge and skill and financial behaviour, and in respect to household wellbeing. This study indicates action is required to enhance financial competence in the Pacific and that financial competence can be enhanced by the deployment of appropriately structured initiatives. Financial competence cannot be left to the actions of individuals as it is evident many people are unable to develop an appropriate level of financial competence without support.

Arguably, ensuring adult populations are financially competent is a fundamental responsibility of governments. The importance of financial competence has been accepted by an increasing number of governments, including governments of Pacific Island States[1]. The present study demonstrates the value for individuals, and for their households (and by extension their communities), of being able to manage money effectively and securely through access to a safe and accessible bank account; the value of household budgeting and planning; the importance of households being able to access well regulated credit services and the importance of appropriate financial disclosure and consumer protection. It is the responsibility of governments in the Pacific to ensure their populations are able to develop an appropriate level of financial competence and can engage with the money economy and the formal financial system through an appropriate enabling environment.

Financial competence is a national issue and requires a coordinated response enacted through an appropriate policy framework. There is considerable value in Pacific Island States developing a coordinated national approach to improving the financial competence of their populations in particular as the enabling environment required for competent participation in the formal financial system is still developing. The development of national action plans and strategies enables a diverse range of actors to work together to enhance the financial competence of Pacific Island communities and populations and the development of an appropriate enabling environment. Establishing baselines on financial capability is a vital precursor to national strategy formulation.

1 Refer for example the 2008 Coombs Declaration