

Financial Capability Index



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Background

In recent years, there has been a growing emphasis on building the financial capabilities of low-income households in developing countries to help improve their economic well-being. The concept of financial capabilities focuses on changing behaviors, in addition to increasing knowledge or literacy. However, to date, there has been limited understanding and evidence of the most relevant, immediate, and appropriate methodologies for helping change the financial behaviors of low-income households.

In sum, this shift toward financial capabilities will require new, flexible, and accessible programs, along with tools to measure their efficacy. One of the tools needed is a simple but effective way to gauge financial capabilities of individuals, using financial capability constructs meaningful in the local context. To this end, Microfinance Opportunities (MFO) has developed its Financial Capability Index a simple and versatile questionnaire that generates a financial capabilities “score” for anyone who takes it.

Uses of the Financial Capability Index

The Financial Capability Index can be used:

- To measure the financial capabilities within a particular low-income group and prioritize the needs across various communities/regions
- To compare the levels of financial capabilities across low-income groups
- To identify key target groups for financial education programs in low-income settings
- To identify priority content areas for financial education programs for the target group
- To measure changes in financial capabilities over time

Methodology for Developing the Index

The index was developed through participatory research and testing in six countries: India, Pakistan, Cambodia, Kenya, Malawi and Costa Rica. The objectives of the research were the following:

1. Identify how low-income people in developing countries define financial capabilities
2. Evaluate how definitions vary across low-income communities in countries/contexts
3. Identify common indicators of financial capabilities across countries and contexts

Above all, the research aimed to develop a ground-up, inductive methodology for capturing participants’ own ideas about financial capabilities, instead of imposing a single outside framework of what it means to be financially capable. In this area, MFO drew heavily on collaborations with Guy Stuart, faculty member at Harvard’s Kennedy School of Government, an expert on such participatory methodologies.

The research method entailed focus group discussions in which key informants first discussed what financial capabilities mean in their communities. They then ranked households in their communities according to their levels of financial capabilities and analyzed the differences between households with low and high levels of financial capabilities. The statements made during the discussions and ranking process were systematically recorded, ranked, and weighted.

From these statements, indicators were developed, relating to 3 main categories:

1. Basic behavior around managing money (e.g. planning, saving, spending, borrowing, earning, investing, use of formal or informal financial institutions)
2. Personal characteristics (e.g. careful about spending money, confidence in making financial decisions, ability to plan ahead)
3. Relationships around money (e.g. part of a reciprocal support network vs. self-sufficiency)

The indicators were then developed into a simple-to-use questionnaire that can be administered to individuals or target populations, to generate individual “scores” indicating financial capabilities.

Generic vs. Country-Specific Indices: Potential Uses & Variations

The results to date and going forward entail several potential forms and uses of the Financial Capability Index:

1. The generic index – the data gathered from all six countries has been synthesized into a single index, focused on the commonalities across cultures. Based on the diverse input, this index has wide relevance across world cultures and can be applied “as-is” by users.
2. The generic index, with adaptations – a variation is for users to field-test the generic index with a new population and then adapt the questionnaire based on the input received from participants (i.e. reword or replace questions that have little meaning in the local context). The revised index can then be applied widely to the new population.
3. The country-specific index – a final variation is to build a country-specific index from the ground up, following the methodology developed by MFO. This option is the most resource-heavy but brings high potential for an index that resonates with a particular population.

Next Steps

Based on the feedback gathered to date, MFO will take the following steps in 2010:

1. Develop a Toolkit that includes:
 - an introduction describing the purpose and potential uses of the index
 - the questionnaires currently available
 - a protocol to guide the translation and administration of the questionnaires
 - a program that can be used to collect and score the responses
 - guidance for analyzing the results for sub-groups of survey respondents (i.e. by age, gender, geographic location, etc.), for individuals or for clusters of questions
 - a protocol for adapting the index based on local results
 - a protocol for building new, country-specific indices from the ground up.
2. Develop a web-based platform that organizations can use to administer the existing questionnaires, analyze the data, and/or upload the data.

The toolkit and web-based platform will provide a large database for comparing financial capabilities across populations and countries.

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