They have little income and no unity in the family

AN EXPLORATION IN

HOW RURAL LOW-INCOME HOUSEHOLDS PERCEIVE FINANCIAL CAPABILITY

GIZ-NABARD RURAL FINANCIAL INSTITUTIONS PROGRAMME

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This paper analyses results from 96 Focus Group Discussions with 524 low-income people in 8 districts of Odisha, Uttarakhand, Rajasthan, and Karnataka. The title of the publication combines two of the very commonly perceived characteristics of households with a low financial capability level. The study team has benefited from the variety and richness of the statements made in the group discussions. We have taken the freedom to reflect some insights of the research in the title of the study using words of the study participants.

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Published By
Deutsche Gesellschaft Für Internationale Zusammenarbeit (Giz) Gmbh

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New Delhi, March 2014

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Abbreviations

MFI – Microfinance Institution, an organization offering financial services to low income households. MFIs have different legal forms.

NGO – Non Government Organization, entity of civil society which with its actions and strategies fills gaps in development left open by the government and market. NGOs often address education and empowerment issues. NGOs contribute to the development of microfinance in forming groups which are then linked to banks. The transformation of some MFI NGOs into commercial MFIs has been the starting point for a massive growth in microfinance starting from the early 2000s.

PACS – Primary Agricultural Credit Societies are village-level cooperatives, which are linked to a system of rural banks at the district and state level. PACS are also involved in the distribution of inputs and marketing of outputs of farmers.

SHGs – Self Help Groups, a model of financial intermediation as well as empowerment used by civil society and the government. Ideally SHGs are formed to enable its members to evolve strategies to overcome poverty and inequality in their community. Part of this empowerment process can also be access to financial services through bank linkages. Bank deposits are a prerequisite for availing loans. Part of the SHGs also builds up internal fund through voluntary savings mobilisation.

MGNREGA – The Mahatma Gandhi National Rural Employment Guarantee Act of the Government of India commits to providing 100 days of unskilled work, at a minimum wage, to those who demand this work. The government implements a scheme to provide such work, which provides protection, in terms of a minimum earning per year, to those who need such employment.

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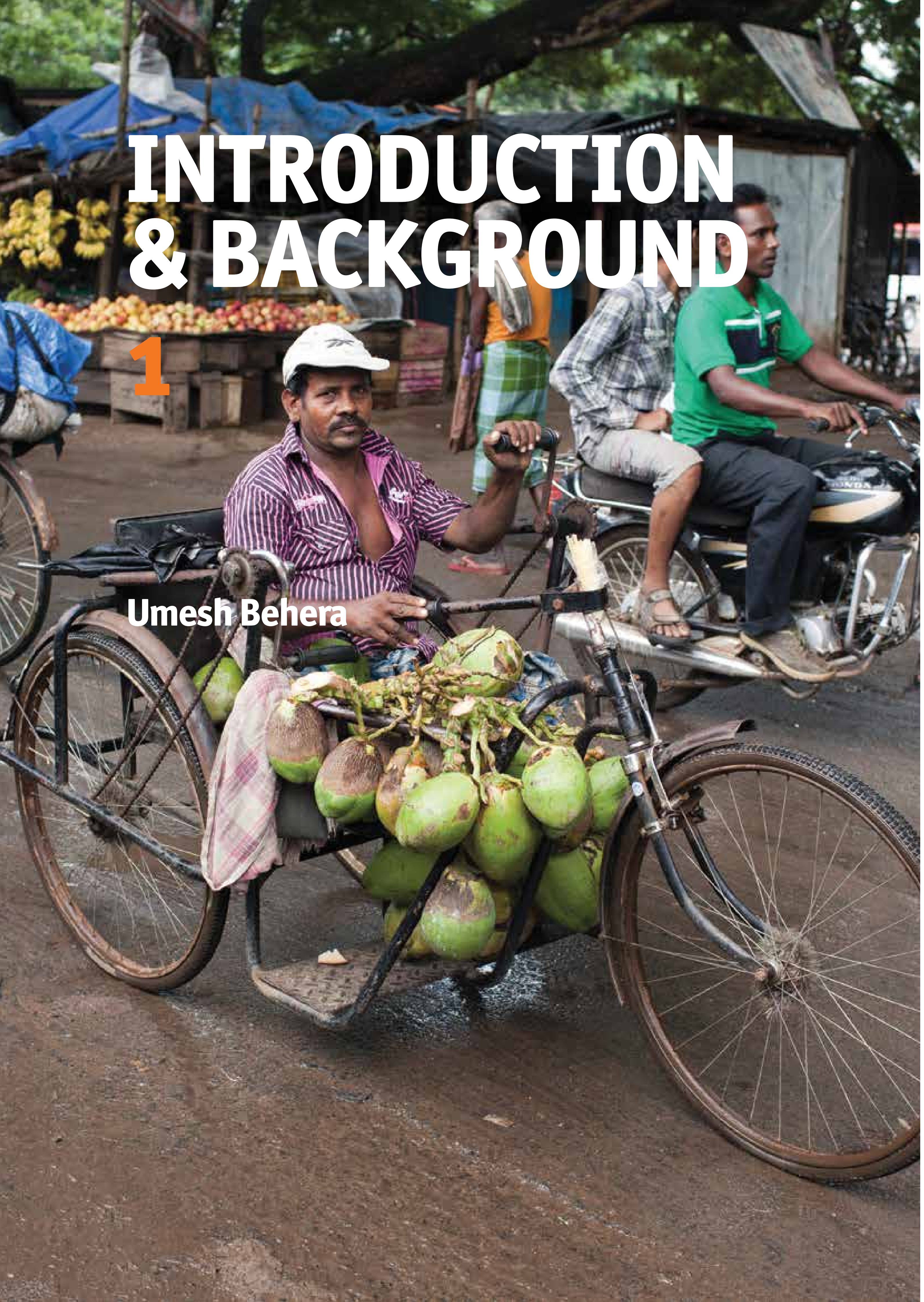


INTRODUCTION & BACKGROUND

1

Umesh Behera

Mr Umesh Behera used to earn money to support his family by picking coconuts from trees in his home village in Odisha. One day, 20 years ago, he broke his back after he fell from a tree while doing his job. The accident rendered him paraplegic and he was not able to work in his job anymore. The family lost their only stable income and did not have any emergency savings or even insurance cover to manage this new situation. In addition, medical expenses had to be borne by the family over the following years. Many years later, Umesh received a loan from a local NGO which gave him the opportunity to lease around 100 coconut trees for INR 8,000 per year. He hired a picker to harvest the ripe coconuts from the leased trees and now sells these coconuts at the nearby market and hospital using his wheelchair as a mobile selling counter. Together with his wife, he generates additional income by producing and selling mats, baskets, fans and brooms made of the palm leaves of the leased coconut trees. The financial situation of the family is still very difficult. However, it has slightly improved compared to the past. With a monthly income of around INR 4,500, recurrent medical expenses are a particular burden for the family.

Padmabati Das

MrsPadmabati Das, also from Odisha, took part in a Community Animal Health Worker training class after an unsuccessful attempt to run a small grocery store financed by a loan. In this class she was taught traditional and modern ways of animal health treatment. These days she utilizes the acquired knowledge to provide local farmers with medicines and vaccinations for their cattle. The farmers pay her for the service and the medicine. She receives the medicine and other medical consumables from a supporting NGO whom she repays after the consumption of the products and after she receives payments from the farmers. Because of her excellent work attitude, she has the chance of being promoted to a government health worker. Both her daughters attend school. Her husband works as a plumber in Gujarat and transfers around INR 2,000 every month to cover the basic needs of his wife and their daughters. He has not been home for almost two years.

Mamta Devi

Mrs Mamta Devi from the mountains high up in Uttarakhand is not only a busy mother and housewife but also a teacher at a local Anganwadi, a government sponsored child-care and mother-care centre. Her husband could not find any job in the remote area they live in and wanted to migrate to a more urban area to earn some income to support his family. In order to help her husband stay with the family, Mamta took a loan from a local Microfinance Institution to invest into a small electronics supply store. Her husband is managing this store that sells different kinds of electronic items, computer peripherals as well as a mobile phone account charging service. Since the income generated by this activity is constantly increasing, the family has planned to expand this business.

The Beheras, the Das and the Devis represent typical rural Indian low-income households: their living situations are similar to millions of other households but, at the same time, they have their very individual challenges and advantages. Different factors and circumstances influence their ability to access financial services and their choice how to use them. Their decisions and behaviour are shaped by different individual characteristics, strengths and weaknesses, as well as the environment they are living in.

All three families live in poverty or off a very low income. All three families have no access to formal financial services and are thus excluded from the financial sector. They are all part of the target group which the Government of India attempts to include into the financial system, so that they get more opportunities to develop themselves and hence improve their economic situation. If, for example, Mr Behera had insurance coverage before his accident, he could have dealt better with the absence of regular income and the increased medical bills. This would have helped him in getting a new job much faster and generate more income for himself and his family. He could have invested his income in education and further business development.

Looking Beyond Access to Finance and Financial Literacy

For long, financial inclusion strategies have primarily focused on the supply of financial services through formal financial institutions. This is also expressed in the Reserve Bank Of India's (RBI's) definition of financial inclusion: "Financial inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players." (RBI, 2011)

However, after supply-driven strategies such as the opening of no frills accounts had been less effective than expected, stakeholders increasingly realized that access alone is not enough to stimulate the demand for and use of financial services. Financial literacy was discovered as the missing link: *"Financial inclusion and financial literacy are twin pillars. While financial inclusion acts from supply side providing the financial market/services what people demand, financial literacy stimulates the demand side – making people aware of what they can demand."* (RBI, 2013)

Taking into consideration the overall objective of Financial Inclusion which is to empower the excluded to contribute to economic growth of the society and thereby improve their wellbeing[1] , this view suggests that people who have access to financial services and are financially literate will automatically also use these services to their own benefit. This means they make the right choices and use financial services effectively. It implies that people who should be financially included have the capability to manage their money and to use financial services for improving their own living conditions. **But, how do people make their decisions? What influences their decision-making and their financial behaviour? How do people use financial services and how does this impact on their livings conditions?**

In reality people do not always choose the financial services which might have been the best for them in a certain situation because they are influenced by many factors: their culture and society, their individual attitudes and characteristics, as well as their very personal perceptions of what is good for them and what is not. The story of Mrs Padmabati shows that using a loan to start a small business did not work out for her. The business failed, but she still had to repay the loan. She only got back on her feet when she participated in training and improved her skills, which enabled her to take on a new job. She also did not see any opportunity to find a job for her husband closer to their home and hence accepted his absence after migration. Mrs Mamta did everything she could, even indebted herself, in order to enable her husband to stay in the same village. Both women live in different environments; have different knowledge, skills and attitudes, and hence also different abilities to use the financial services available to them.

1 Reserve Bank of India (2011a): Financial Inclusion – A Road India Needs to Travel, Article by Dr. K.C. Chakrabarty, Deputy Governor, Reserve Bank of India, http://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=607: *"Empirical evidence shows that economic growth follows financial inclusion. Boosting business opportunities will definitely increase the Gross Domestic Product, which will be reflected in our national income growth. People will have safe savings along with access to allied products and services such as insurance cover, entrepreneurial loans, payment and settlement facility, etc… Inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process."*

Defining Financial Capability

In social science theories there are different definitions for concepts like "capability" or "capacity" used for different purposes. For the purpose of this study we define capability as the ability to act, and financial capability as the ensemble of abilities related to making informed financial choices, managing money effectively, and using financial services for one's own benefit. The ability to act is shaped by personal attributes as well as by the environment in which actions are performed. And, vice versa, the ability to act, if realised, shapes personal attributes and the environment (figure 1). Personal attributes, which are often referred to as human capital, comprise knowledge, skills and attitudes as well as physical, social, cultural and economic properties (e.g. health, social status and economic assets), which a person brings in to interacting with his/her environment. The environment comprises physical infrastructure, social and cultural relations, and economic conditions given in the geographical areas where people act and interact.

For the purpose of this study we define capability as the ability to act, and financial capability as the ensemble of abilities related to making informed financial choices, managing money effectively, and using financial services for one's own benefit.

Both personal attributes and the environment enable or constrain the ability to act, and the ability to act enables or constrains both the development of personal attributes and changing a given environment. The financial capability concept tries to capture this complex situation and, thereby, goes beyond the financial literacy concept. It asks ***which knowledge, skills, and attitudes people have to make informed choices*** regarding the use and management of money as well as ***how external factors such as access to financial products and the conditions to use them influence these choices.*** It also asks ***how personal attributes and environmental factors can be changed to increase the ability*** of people to manage money and use financial services for their own benefit.

FIGURE 1

THE ABILITY TO ACT – A VISUALISATION

People need knowledge and skills in order to differentiate between given financial options and to assess the effects of these options if chosen. The ***attitude*** of individuals and their ***preferences*** are also likely to influence their financial decision when selecting a financial product or spending money on certain items. ***Personal attributes*** and ***environmental factors*** influence the ability to use money effectively. ***Social pressure*** or the ***lack of infrastructure*** often prevents a decision which would have been the most effective otherwise. The ***availability of financial products*** which meet the demand, need and financial situation of a person impacts the effectiveness of a financial decision: If the product design does not meet the preferences or requirements of a person, this person's ability to make beneficial choices is restricted. Furthermore, financial capability can depend on factors such as the level of education, the position within one's community, the degree of harmony and coordination between family members, and the opportunity of a person to engage in social networks and forms of self-organisation such as Self-Help Groups or cooperatives.

The financial capability concept takes into consideration the many factors which influence the ability to manage money and to use financial services in a way that adds value to people's lives. The strength of their influence and their interplay result in different levels of financial capability. While we start from a generic definition of financial capability, it is important to note that the strength and interplay of factors influencing the ability to manage money and to use financial services is predominantly local, and consequently also the people's own perception of what constitutes financial capability. Thus, we can expect that the ability to manage money and to use financial services as well as the people's own perception of this ability varies across regions. In this study, therefore, we refer to the **local financial capability concept** as defined by the people's own perceptions in their local contexts, or the limited geographic areas chosen for the study.

Objective and Methodology of the Study

The objective of this study is to understand the financial behaviour of low-income people by looking at their own perceptions as users of money and financial services: How do people perceive money and financial services? What do they mean to them? How do they make their financial decisions? Which factors support or constrain their financial behaviour and capability?

The study focuses on low-income microfinance clients from different regions in India to capture the diversity of financial capability conditions and perceptions.

Understanding local financial capability requires a methodology that starts from the people's own perceptions and priorities when it comes to managing money and using the financial services.

The approach used in this study has been inspired and guided by the Financial Capability Index (FCI) methodology developed by Microfinance Opportunities (MFO)[2]. The Financial Capability Index is a tool that measures the level of knowledge, skills, and attitudes needed to make informed judgments and effective decisions regarding the use and management of money. To avoid imposing a preconceived framework foreign to the actual local realities, MFO's methodology is based on the idea of measuring financial capability levels of communities based on their own ideas about financial capabilities.

The markers of the FCI are derived from Focus Group Discussions (FGDs) with participants coming from the target groups of financial inclusion strategies. Those markers can be grouped into three main categories: 1) basic behaviour 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); and 3) relationships around money (e.g. part of a reciprocal support network vs. self-sufficiency). This methodology allows for developing local as well as country-specific and generic indices that focus on the commonalities across regions and countries. The Financial Capability Index can be used in a variety of ways, among them as a) an assessment tool to measure financial capability across a population to identify priority target groups for a financial education program, b) a design tool to prioritise content areas for a financial education program (e.g., saving, budgeting, debt management), and c) an evaluation tool to measure changes in the financial capability of target groups over time in order to help assess effectiveness of an intervention.

The study collected qualitative data through 96 Focus Group Discussions (FGDs) with 524 low-income people in 8 districts of Odisha, Uttarakhand, Rajasthan, and Karnataka. These FGDs generated 3,399 statements which, through a coding and clustering process, resulted in identifying 4 focal areas of financial capability as perceived by the FGD participants.

Chapter 2 describes in detail the methodology used for constructing the local financial capability concept based on the statements made in the FGDs. Chapter 3 analyses the statements, illustrates financial capability levels, explores the cognitive, behavioural and environmental aspects of the statements, and concludes with a summary of key abilities identified as relevant in the local financial capability concept. Chapter 4 analyses the different financial capability levels and interprets differences between these levels as changes in the process of increasing financial capability. Chapter 5 provide first, still tentative, conclusions regarding intervention areas for supporting the development of financial capability.

2 MFO is a US based NGO that specialises in Financial Capability and Education. The following description of its FCI methodology is based on: Microfinance Opportunities, Financial Capability Index, A Toolkit for Use, http://microfinanceopportunities.org/fci-portal.

CONSTRUCTING THE LOCAL FINANCIAL CAPABILITY CONCEPT

Methodology and Qualitative Analysis of FGD Statements

2

As mentioned before, understanding local financial capability concepts requires starting from the people's own perceptions and priorities. The approach used in this study to some extent reflects what researchers call "grounded theory" (Charmaz, 2006). Rather than starting from preconceived theories the researcher develops concepts through a process of data collection and analysis in order to identify factors that can explain actions and behavioural traits of the people studied through open interviews. Research findings, therefore, are not representative for larger populations but provide an in-depth understanding and data-based interpretation of actions, behaviour and social structures.

Following grounded theory principles allows us to develop local financial capability concepts through a step-wise analysis of statements made by the participants of Focus Group Discussions (FGDs) with low-income people in four regions of India. They also enable us to separate personal and environmental factors, which influence and constitute financial capability, and to arrive at insights that are relevant for stakeholders who want to contribute to the financial capability development of low-income people.

In this chapter we will first describe the sampling and FGD approach, and explain in detail the methodology by which we arrived from the FGD statements to the local financial concept through a step-wise clustering process.

2.1 Sampling and Conduct of Focus Group Discussions

To cover the diversity of India, the FGDs were conducted in four states (Odisha, Uttarakhand, Rajasthan, and Karnataka). Within each state a pair of local researchers, who are familiar with the local conditions and languages, was identified and trained in using the FCI methodology as well as the sampling method.

The following criteria have been applied for conducting the FGDs:

- First, the participants should consist of low-income households who have limited or no access to formal financial services and who live in areas where the population of villages and towns does not exceed 50,000.
- Second, the participants should represent three groups (members of Self-Help Groups - SHGs, members of Primary Agricultural Credit Societies - PACS, and clients of Microfinance Institutions – MFIs, which can be considered the primary sources of microfinance in India), as well as the group of financially excluded people (without relationships to SHGs, PACS, MFIs, banks or any other formal financial service provider[3]).
- Third, all four types of participants should be present and approachable in two districts each in the four study states.
- Fourth, 12 FGDs (3 per group of participants) should be conducted in each study district.

The 96 FGDs were conducted with 524 participants in the Sambalpur and Puri districts of Odisha, the Bagalkot and Tumkur districts of Karnataka, the Ajmer and Alwar districts of Rajasthan, and the Tehri Garhwal and Haridwar districts of Uttarakhand. 73% of the participants were women, 35% of the participants had no education, 39% of the participants were self-employed and 25% of them worked for wages or salary. The average age of the participants was 38 years.

The FGDs started with an introduction to the objective of the study. Then the participants were asked to define their community in order to ensure that the participants were talking about the same group of people. Most participants defined their village or a hamlet in the village as their community.

Questions asked by the researchers were open-ended in order to allow for a genuine discussion and making participants find their own definitions. Questions asked during

3 In this definition, households who had a bank account only for MNREGA payments were considered as having no formal financial relationships.

the group discussions were: *When you think about a household in your community, whether it is rich or poor, that uses and manages money well, what comes to your mind? Now, what comes to mind when you think about a household that does not manage its money well?*

The researchers guided the discussions around the following four situations: 1) Meeting day-to-day needs, 2) managing life-cycle event expenses such as births, education, weddings, and deaths; 3) dealing with emergencies, and; 4) taking advantage of opportunities. These situations reflect basic scenarios where decisions on the use of money are needed. Each household is likely to employ a different approach, planning process, different relationships and actions to manage these four situations to the best of its knowledge and advantage. The aim of asking these questions was to understand *how* people act in such a situation: *what* do they do, *how* do they choose and, most importantly, how *can* they choose?

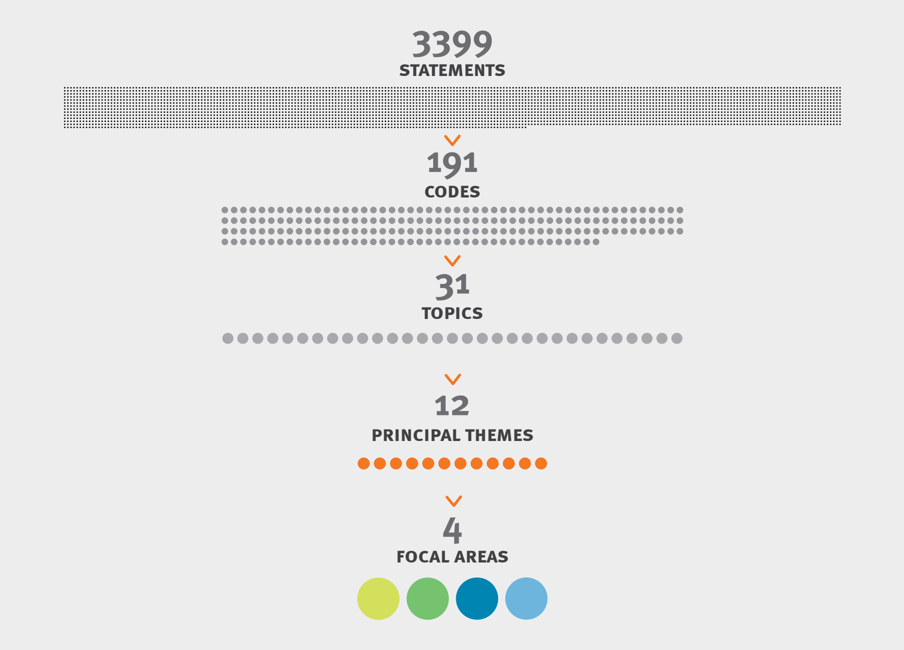
Furthermore, the participants were asked to imagine households in their community with different abilities to use and manage money, and classify the financial capability of these households according to the following scale: 1) very low, 2) rather low, 3) medium, 4) rather high, and 5) very high. Based on this classification, participants were then asked to describe characteristics of one real household in their community for each of these capability levels. The participants were asked not to reveal the name of the households to the researcher.

Finally, the participants were asked to explain their choice of households representing the different capability levels: Are there any common characteristics between households in the same capability class? Participants were made to discuss the characteristics of the five different households: Does that make them similar or different to other households which would also be assigned to the same capability level? Do other households in the same capability class behave in the same way or differently? These concluding discussions helped in verifying and refining the statements made and allowed an in-depth understanding of the participants' perceptions about financial capabilities.

2.2 Step-wise Clustering of Statements

3,399 statements were collected from 524 participants during 96 FGDs. Together with the attributed financial capability level and the basic demographic data on the FGD participants the statements were then entered into a database. The following clustering of statements consisted of four steps, which aimed at fitting the whole dataset into a logical frame which helps understanding the factors that influence financial capability (figure 2).

FIGURE 2
FLOW OF THE CODING PROCESS



In a **first step**, the researchers assigned **191 codes** to the 3,399 statements. For example: The code 'low Income' was assigned to statements such as 'They are small farmers', 'They have low income', 'They have petty business' and the code 'irregular earnings' to statements like 'They are daily wage labourers', 'They are into contract farming' and 'They have irregular work opportunities' (s. Table 1). During this process broader, recurring topics were identified, which allowed to cluster the statements more appropriately.

TABLE 1
EXAMPLE OF CODING STATEMENTS

STATEMENT	CODE
'They are small farmers'	
'They have low income'	'Low income'
'They have petty business'	
'They borrow frequently and from many people'	
'They take small loans from many sources'	'Borrows from multiple sources'
'They have loans available from more than 4 MFIs'	
'They try to save but cannot'	
'They have small savings sometimes'	
'They have small savings and infrequent'	'Irregular savings'
'They save irregular'	
'They save sometimes'	

Thus, in a **second step** the statements were clustered into **31 topics**. For example: The codes 'low income' and 'irregular earnings' have the common topic 'how much income households earn'. Based on this, all 3,399 statements were freshly assigned to the new 31 topics to ensure that the original meaning of the statements and the participant's own perceptions was preserved. This involved re-clustering of statements since statements with one code can relate to different topics. For example: Statements like 'they have a petty business', 'they are small farmers' and 'they have low income/less earning' were first coded as 'low income'. After creating the topics, the same statements were now assigned to the topics 'what income sources households have', 'what land households have' and 'how much income households earn' (s. Table 2 and box 1).

TABLE 2
EXAMPLE OF CLUSTERING STATEMENTS INTO TOPICS

STATEMENT	CODE	TOPIC
'They have a petty business'	'Low income'	'What income sources households have'
'They are small farmers'	'Low income'	'What land households have'
'They have low income/less earning'	'Low income'	'How much income households earn'
'Less paid than factory workers'	'Has a bad job'	'How much income households earn'
'They are middle class people'	'Has a good income'	'How much income households earn'
'They are into business'	'Has a good business'	'What income sources households have'
'They have good job'	'Has a good job'	'What income sources households have'

In a **third step**, the 31 topics were clustered into **12 principal themes** as several topics were found to belong to a similar theme. For example: Besides the topic 'how much income households earn', topics such as 'how many members of the household earn income', 'what sources of income households have', 'how time is managed', 'how regular income is' and 'how many income sources households have' reflect different aspects of income generation. Hence, these topics again can be clustered into the principal theme 'how households generate income'.

In a **fourth step**, the principal themes were clustered again into **4 focal areas**: The first focal area combines statements on how households generate, manage and use money. The second focal area covers statements related to how households plan ahead for their future. The third focal area reflects the way households use financial services. The fourth focal area summarizes statements which refer to social relations, assets and competencies of households.

BOX 1
EXAMPLE FOR THE RATIONALE OF CLUSTERING STATEMENTS

The statement 'they are small farmers' may refer to small income, small land holdings, and an income source of households. It may or may not express all of these meanings. It was hence the task of the researcher to reflect on the context in which this statement was made and, based on this, assign the codes 'low income', 'earns regularly' or 'little land' to the statement. Based on this, topics were identified and linked to the statements. When looking at similar statements it was noticed that all statements related to 'being a farmer' had the notion of being either a small/marginal or a large farmer. This indicates an emphasis on land size rather than on the income generated through farming or the actual farming activity. Hence, all these statements were assigned to the topic 'what land households have', which is part of the theme 'assets households have'. Had the focus been on the income generated by farming activities, the topic 'what income sources households have' in the theme 'how households earn income' would have been chosen.

This approach left space for interpretation by the researchers and those involved in the clustering process. In order to minimise bias, constant feedback was collected from the researchers throughout the whole process. By continuously recalling the situation and context in which a statement had been made, the researchers tried to preserve the original perceptions of the FGD participants.

2.3 Focal Areas and Principal Themes of Local Financial Capability

The four focal areas (generating, managing and using money; planning for the future; using financial services; and using social capital, assets and competencies) derived from analysing and clustering the statements jointly describe aspects that the FGD participants associated with financial capability as well as factors that they perceive as influencing the development of financial capability (see figure 3 for a display of all focal areas).

The first three concepts relate to financial functions: how do people manage money, how do they plan for the future, and how do they use financial services to support the first two functions.

1. The focal area **'generating, managing and using money'** comprises the themes:
   - **Income:** What is the source and frequency of income, how much is the income, etc.?
   - **Spending:** How and for which purposes do households spend money?
   - **Handling money:** Do households use a budget, how do they manage their money?
2. The focal area **'planning for the future'** comprises the themes:
   - **Planning for the future:** Do households plan for lifecycle events and emergencies?
   - **Investments:** Do households use investment opportunities, which type of investment?
3. The focal area **'using financial services'** comprises the themes:
   - **Loans:** Do households have access to loans? What is the source and purpose of loans? Are they able to repay their loans and how do they repay?
   - **Savings:** Where do households save? Do they save regularly? How much do they save? What is the purpose of savings?
   - **Bank accounts:** Do households have bank accounts? Do they use these accounts, how frequently and for what purposes? Do they have an account for their children too?
   - **Insurance:** Do households have insurance? Which types of insurance do they have? How do they use insurance?

In addition, a range of statements made by the participants refer to various factors that influence financial capability (including the first three concepts), rather than to financial functions directly. These statements describe both personal attributes (education, skills and assets) and social relations in the family and community. For the purpose of this study, these statements were pooled in one focal area - 'using social capital, assets and competencies'. It should be noted that this was done to reduce the complexity of the analysis rather than for conceptual reasons. Further research and analysis is required to better account for these personal and environmental factors and their relative strength in shaping financial capability.

4. The focal area **'using social capital, assets and competencies'** comprises the themes:
   - **Social relations within the family and community:** What are the relations among households within the community: do they have a voice and are well-respected? What is the nature of relations that family members have with each other: do they coordinate and make decisions together, are there fights/conflicts? How are the household characterised (large vs. small, part of family support network, vulnerable people in the household)?
   - **Assets:** What kind of housing do households have? How much land do they own? What other assets do they have? Are they generally perceived as poor or rich?
   - **Education and skills:** How well are household members educated? Do they have special skills and attitudes? Are they capable of running a business?

FIGURE 3
FOCAL AREAS AND PRINCIPAL THEMES OF FINANCIAL CAPABILITY

THE LOCAL FINANCIAL CAPABILITY CONCEPT

Quantitative Analysis of Statements and Identification of Key Abilities

3

We start from the assumption that the more statements refer to the focal areas and principal themes of the local financial capability concept the more relevant is their role in shaping financial capability. Hence, in this chapter we analyse the frequency of statements made in the FGDs. Based on this, we try to analyse how topics and themes are described within different levels of financial capability, and which factors enable or constrain people at these different levels. Furthermore, we also try to better understand the nature of statements by distinguishing behavioural, environmental and cognitive aspects.The chapter concludes with interpreting the principles themes of the local financial capability concept as key abilities relevant for describing financial capability.

3.1 Frequency Distribution of Statements Across Focal Areas and Principle Themes

The frequency distribution of statements across focal areas and principal themes points to the most salient, and probably relevant, elements of the local financial capability concept as defined by the FGD participants. Figure 4 shows how statements are distributed across focal areas. Table 3 depicts the distribution of statements across the principal themes in each focal area.

FIGURE 4
DISTRIBUTION OF STATEMENTS ACROSS FOCAL AREAS

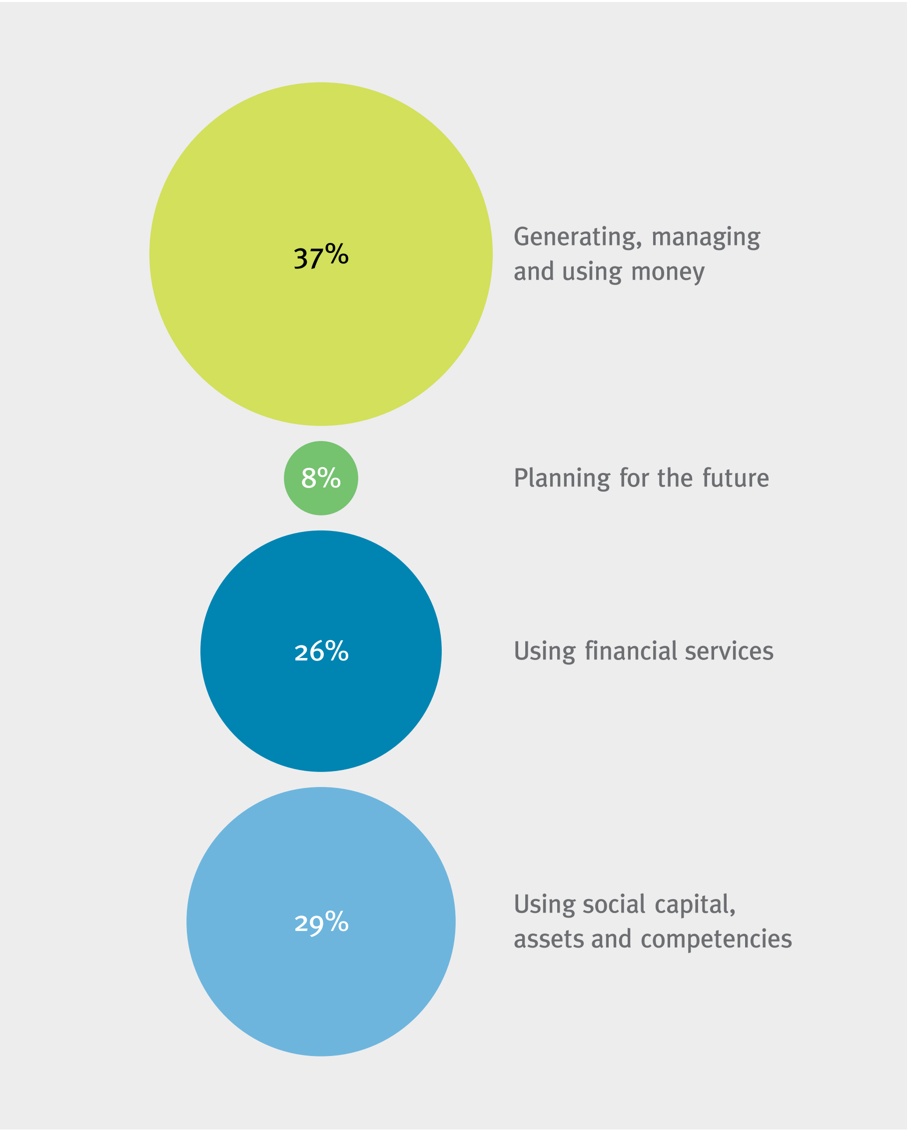


TABLE 3
FREQUENCY OF STATEMENTS PER FOCAL AREA AND PRINCIPAL THEME

Numbers depicted in the table have been rounded and may add up to slightly distinct sums than 100%.

FOCAL AREAS AND PRINCIPAL THEMES	NUMBER OF STATEMENTS	PERCENTAGE OF TOTAL
Generating, Managing and Using Money	1,257	37%
How households generate income	631	19%
How households spend money	530	16%
How households handle money	96	3%
Planning for the Future	256	8%
How households invest	138	4%
How households plan for the future	118	3%
Using Financial Services	898	26%
How households save	376	11%
How households use loans	348	10%
How households use bank accounts	96	3%
How households use insurance	78	2%
Using Social Capital, Assets and Competencies	988	29%
How people interact within the family and community	483	14%
How households use assets	316	9%
How households gain knowledge and skills	189	6%
Total Statements	3,399	100%

37% of the statements were made on 'how households generate, manage and use money'. Within this focal area statements on income (19% of all statements) and spending (16% of all statements) themes are most salient. 29% of the statements are related to which social capital, assets and competencies household have and how they use them. Most salient here are statements on how people interact within the family and community (14% of all statements). Another 26% of the statements were made on using financial services, with statements on savings (11% of all statements) and loans being most salient. Only 8% of the statements refer to the way households plan for their future.

The frequency distribution across themes indicates that people's thoughts are mostly directed towards income generation, spending patterns as well as family and community relations when it comes to describing a household's financial capability. In each FGD 6 to 7 income-related and 5 to 6 spending-related statements were made. Considering that 480 households were described in the FGDs (5 households per FGDs), each household was described with at least one statement on income, spending patterns, and family/community relations.

The frequency distribution of focal areas varies across regions (see Figure 5). For example, in Odisha more FGD participants than in any other states spoke about how to generate, manage and use money, whereas the share of statements related to planning for the future is the lowest among all four states. In Rajasthan the participants referred more often to how households use financial services and less to social relations, assets and competencies. Statements related to the latter focal area were most salient in Karnataka. In Uttarakhand the use of financial services played a major role, whereas planning for the future was not mentioned frequently.

Other variables such as the affiliation of the FGD participants (MFIs, SHGs, PACS, without access to these and formal financial service providers) seem not to have a significant influence. Figure 6 shows that the frequency distribution of the focal areas is similar for these 'financial groups'.

The same is true for socio-economic characteristics of the participants such as gender, average age, and education. Though further research and analysis is required, these findings suggest that mainly regional characteristics are responsible for the variance in local financial capability concepts.

FIGURE 5
DISTRIBUTION OF FOCAL AREAS ACROSS STATES

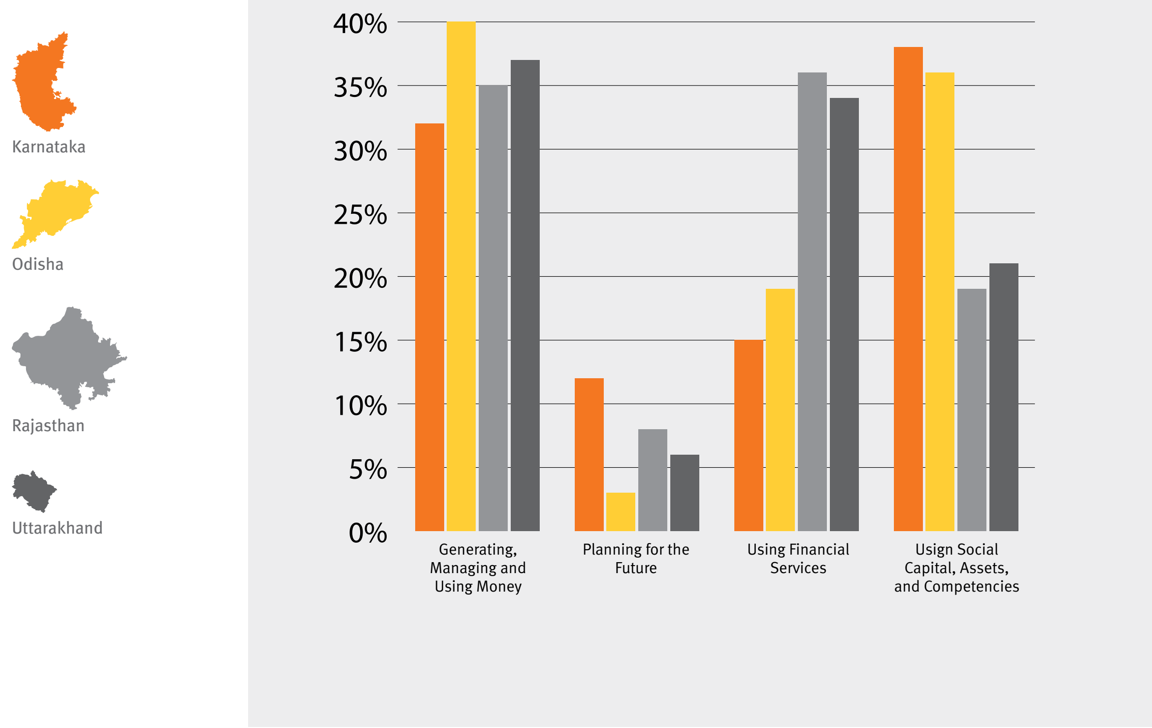
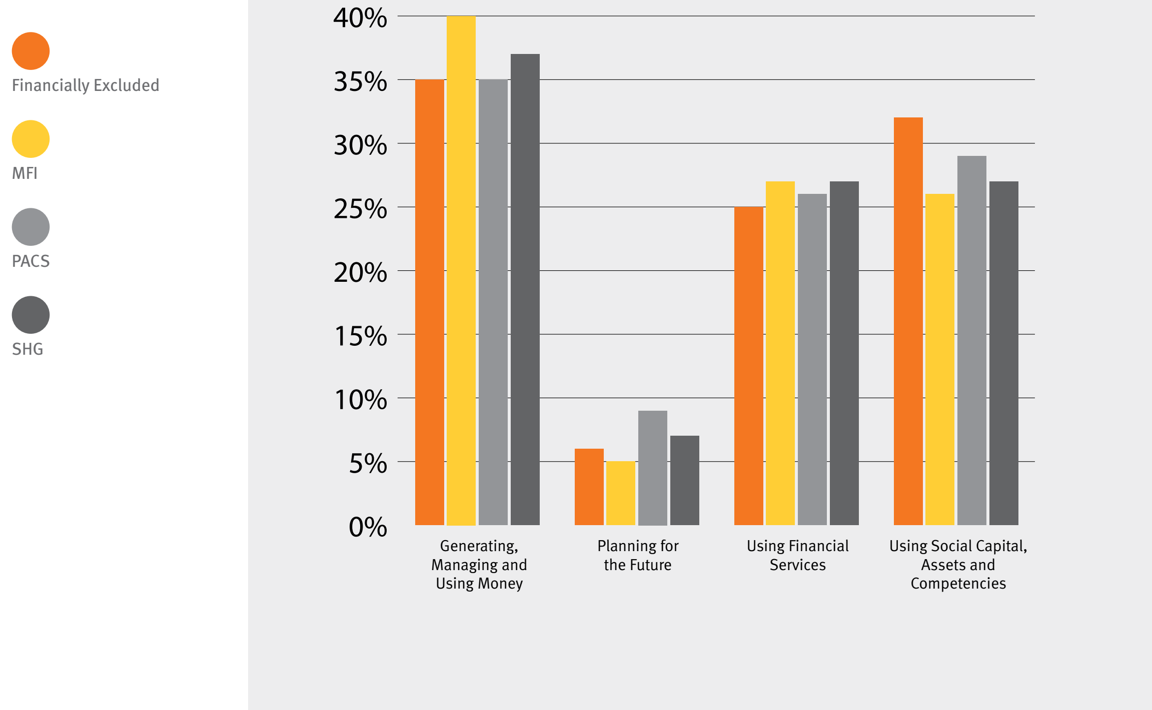


FIGURE 6
DISTRIBUTION OF FOCAL AREAS ACROSS FINANCIAL GROUPS

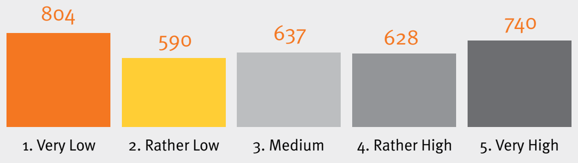


The frequency distribution of focal areas and principal themes indicates their relevance for the FGD participants. In a further step, we can look at **what** statements the participants made and **which financial capability levels** they assigned to these statements. As different participants can associate the same statement with a different capability level, (e.g. 'spends much on social functions like weddings' can be seen as a sign of wealth or lavish spending), the frequency of their high-level or low-level classification may indicate their positive or negative influence as perceived by the participants.

3.2 Examples of Financial Capability Levels

During the FGDs the participants were asked to imagine households in their community with different abilities to use and manage money, and classify the financial capability of these households according to the following scale: Level 1: very low, Level 2: rather low, Level 3: medium, Level 4: rather high, and Level 5: very high. Figure 7 shows the distribution of statements for each level. It shows that FGD participants were more at ease describing either very low or very high financial capability levels.After the clustering of statements into topics, we can now examine how the participants described financial capability levels within these topics. This also indicates how aspects of financial capabilities develop from level to level.

FIGURE 7
NUMBER OF STATEMENTS ACROSS THE VARIOUS FINANCIAL CAPABILITY LEVELS



For example, within the topic 'how much income households earn' we find statements that range from 'they have low income', which was classified as very low financial capability, to 'they are middle class people', which is associated with medium financial capability, and to 'good economic capacity', which was classified as very high financial capability (s. Figure 8).

FIGURE 8
FINANCIAL CAPABILITY LEVELS: 'HOW MUCH INCOME HOUSEHOLDS EARN'

FOCAL AREA Generating, managing and using money > **THEME** How households generate income > **TOPIC** How much income households earn

STATEMENT	FINANCIAL CAPABILITY LEVEL
They have low income	Very Low
They have little income	Rather Low
They are middle class people	Medium
They have good earnings in family	Rather High
They have good economic capacity	Very High

FIGURE 9
FINANCIAL CAPABILITY LEVELS: 'WHAT LOAN SOURCES HOUSEHOLDS HAVE'

FOCAL AREA Generating, managing and using money > **THEME** How households use loans > **TOPIC** What loan sources households have

STATEMENT	FINANCIAL CAPABILITY LEVEL
Individuals, moneylender	Very Low
Moneylender, informal sources	Rather Low
PACS, SHG, community	Medium
PACS, banks	Rather High
Banks, PACS	Very High

Similarly, Figure 9 shows the associations of loan sources with financial capability levels. Households at Level 1 are described as only being able to access loans from other individuals and moneylenders. This broadens slightly at Level 2 where other informal sources play a role as well. Households with medium financial capability are mostly described as having access to finance from PACS and SHGs. At Level 4 banks are starting to play a role, and truly financially capable households at Level 5 are thought to have diverse sources for accessing loans: mostly PACS and banks, where interest rates are lowest.

For the topic 'what households spend on' there is an interesting trend with regard to the school education of children (figure 10): Households at Level 1 hardly spend money on school education and can only afford irregular schooling. At Level 2 most of the children are attending government school which changes in Level 3 to partly private schooling. At Level 4 and 5, the education of children plays a very important role and money is being spent on good private schools and higher education.

In the latter example, relatively more statements were made to describe households with low and very low financial capability levels than others (figure 11). This may indicate that the participants regard limitations in spending as well as bad spending behaviour as serious constraints in developing the financial capability of households to higher levels.

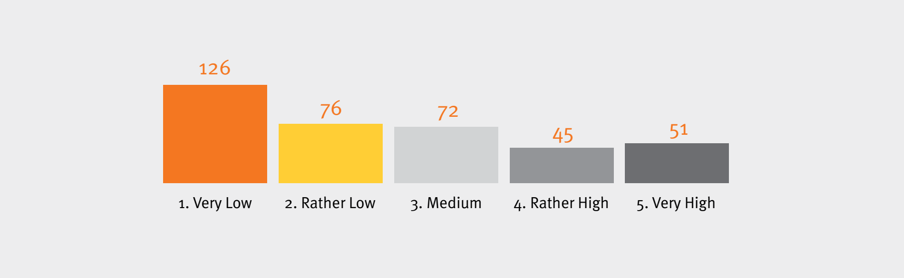
The classification of statements according to assigned financial capability levels helps to understand what constitutes the different levels of financial capability and how aspects of financial capability develop across these levels. It can thus indicate how a household needs to develop or how certain factors need to change in order to enable a household to reach higher levels of financial capability, as perceived by the respondents.

FIGURE 10
FINANCIAL CAPABILITY LEVELS: 'WHAT HOUSEHOLDS SPEND ON'

FOCAL AREA Generating, managing and using money > **THEME** How households spend > **TOPIC** What households spend on

STATEMENT	FINANCIAL CAPABILITY LEVEL
Alcohol and bad habits, irregular schooling and food	Very Low
Alcohol, partly sending kids to government school	Rather Low
Good food, very little alcohol, kids in government school, partly private school	Medium
Private schools, higher education	Rather High
Good schools, high priority on education	Very High

FIGURE 11
NUMBER OF STATEMENTS PER CAPABILITY LEVEL: 'WHAT PEOPLE SPEND ON'

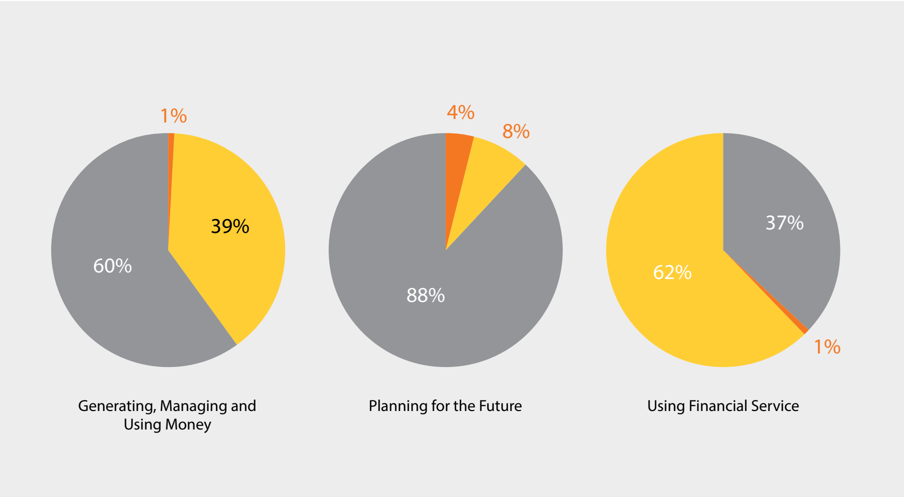


3.3 Cognitive, Behavioural and Environmental Statements

The procedure followed above illustrates which information can be derived from the collected statements and how this can help to develop a local financial capability concept. Additional information that can be derived from the statements is the relevance of cognitive, behavioural and environmental aspects in the definition of local financial capability: Do the statements describe the knowledge, skills and attitude people have? Do they refer to how people act by drawing on their financial knowledge, skills, and attitudes? Or, do they describe a specific environment in which people act?

In order to act, a person draws on his/her skills and knowledge within a certain environment. Cognitive and environmental aspects hence constitute the ability to act and influence the actual behaviour. Financial capability as shaped by cognitive factors (e.g. literacy) and the environment (e.g. access to financial services, infrastucture, social structure) needs to be realised in financial behaviour.

FIGURE 12
FREQUENCY OF COGNITIVE, BEHAVIOURAL, AND ENVIRONMENTAL STATEMENTS



As explained earlier, the 4th focal area "using social capital, assets and competencies" does not reflect a financial concept itself but it rather influences the other three concepts as well as the overall financial capability level. Hence in this analysis we are focussing on the 3 main focal areas. The vast majority of statements involve behavioural (45%) and environmental aspects (47%). Only few statements refer to pure cognitive aspects (8%). This frequency varies strongly across the focal areas of financial capability (s. figure 12). It should be noted that behavioural and environmental factors are best observable and, therefore, come to mind first when asked to describe a household in respect to financial capability.

The vast majority of statements made within the focal areas 'generating, managing and usingmoney'(60%) and 'planning for the future'(88%) refer to behaviourial aspects. Environmental statements (62%) are most salient within the focal area 'using financial services'. This indicates that when it comes to financial services the FGD partipants mainly focused on what access to finance households have, and how this access enables or constrains their financial capability.

Cognitive aspects appear to be irrelevant within the focal areas 'generating, managing and usingmoney'(1%), 'planningfor the future'(4%), and 'using financial services' (1%). However, it should be noted that cognitive factors influence financial behaviour and, therefore, are implied in statements on how households manage money, plan for the future and use financial services. Thus, the role of cognitive factors as predicators of financial capability and behaviour is underrepresented here. The reason for this is that financial behaviour follows financial capability (which can be understood as the ability to act), while cognitive factors precede financial capability, or are constituent elements of the ability to act.

When cross-tabulating cognitive, behavioural and environmental statements with the three focal areas we can provide more clarity about how different factors influence financial capability (s. Table 4 where statements are depicted by their nature): Is a household's financial capability constrained by the lack of knowledge, skills and attitudes? Is it fostered by an enabling environment? Does certain behaviour have a positive or negative influence on financial capability?

TABLE 4
NATURE OF FACTORS INFLUENCING FINANCIAL CAPABILITY

	GENERATING, MANAGING AND USING MONEY	PLANNING FOR THE FUTURE	USING FINANCIAL SERVICES
Cognitive	Is able to calculate, is able to prepare a budget, is a hard worker	Knows about different investment schemes, knows how to invest	Knows about different loan products, is able to calculate interest rates
		General education	
Behavioural	Follows a budget, spends too much on alcohol, spends responsibly	Invests well, plans and saves for lifecycle events and emergencies, saves for the future of children and own retirement	Uses a bank account actively, makes use of insurance, does not borrow, repays on time, uses loans for business, saves regularly
Environmental	Has no access to land, there are not enough employment opportunities available	Is exposed to weather and health risks	Has access to loans from bank, gets loans only by pledging jewellery or labour
		Family and community and relations	

3.4 Key Abilities for Increasing Financial Capability Levels

For the purpose of this study we first defined capability as 'the ability to act', and financial capability as the ensemble of abilities related to making informed financial choices, managing money effectively, and using financial services for one's own benefit. Financial capability consists of a variety of abilities, which are influenced by various, enabling or constraining, factors. We then saw how rural people formulate and evaluate various abilities and influencing factors when asked questions related to the 4 focal areas and 12 principal themes of financial capability, and when asked to describe households at different financial capability levels.

The 12 principal themes of financial capability identified in this study can also be interpreted as the key abilities the FGD participants deemed necessary in order to make good financial choices as well as to manage money and use financial services effectively. In order to be able to differentiate and understand the characteristics of the abilities better, the theme 'How people interact within the family and community' has been divided into two abilities: 'the ability to coordinate within the family' and 'the ability to participate in community life'.

Taking on step further, each theme can also be understood as representing a particular 'ability' to act. In order to understand these abilities' contribution to increasing the overall financial capability levels of rural households, they need to be looked at separately though.

In the following paragraphs we describe these abilities with the help of the topics that were mentioned by the participants themselves including constraining and supporting factors (as per the level of financial capability these topics were associated with).

ABILITY TO GENERATE SUFFICIENT INCOME

The 'ability to generate sufficient income' is affected by the number of income sources, the type of income sources, the number of earners who contribute to income generation, the regularity of income and the way time is managed. Households apply combinations of income sources and earning members to yield the income deemed sufficient for them. The ability to generate sufficient income depends on the availability of choices of income sources and their combination within a household.

The irregularity of available income, very little choice in terms of activities for income generation and employment as well as poor time management are the major constraints for the households' ability to generate income. A high number of income sources as well as the specific source of income (like own business, agriculture or fixed job) are in contrast key enablers for a high ability to generate income.

ABILITY TO SPEND MONEY RESPONSIBLY/WISELY

The 'ability to spend money wisely' has been associated with households which spend money for items that generate a benefit for the whole household and help the family to improve its living conditions. Spending on children's education is a priority also in terms of planning for the future. Households which spend on vices and bad habits and who do not control their spending are described as limited in this ability. This ability is majorly influenced by personal preferences and attitudes.

ABILITY TO HANDLE MONEY ON A DAILY BASIS

The 'ability to handle money' depends on how households are able to balance income and expenditure, and the knowledge to use budget planning instruments. For example, an environment of daily earnings and a 'hand to mouth existence' constrains the household in this ability as planning becomes very difficult. Once households are able to manage their income, the role of budgets and plans becomes an enabling factor, as mentioned by FGD participants.

ABILITY TO PLAN FOR THE FUTURE

The 'ability to plan for the future' requires taking into account longer-term aspects of income and expenditure. Planning of income is seen to be related to business development and investments. Planning of expenditure mainly refers to education and life cycle events as well as creating reserves for emergencies. Hence households who do not plan ahead for these occasions and who do not have a plan are described to be constrained in their ability to plan for the future and vice versa.

ABILITY TO INVEST

The 'ability to invest' refers to the identification and use of investment opportunities. It requires access to investment opportunities and the attitude to actively look for these opportunities. Not-investing was not identified as a constraint in the ability as it was not mentioned for households with low financial capability levels. Only households described in the medium and higher levels were associated with this ability as an enabler for financial capability. Especially business opportunities and land seem to be the most admired investment opportunities.

ABILITY TO USE BANK ACCOUNTS

The 'ability to use bank accounts' has been associated with households which have access to saving or loan accounts, and actually make use of banking services. Households which have bank accounts but do not use them were not considered able to use bank accounts.

ABILITY TO USE LOANS

The 'ability to use loans' refers to access to loans from diverse sources such as banks and PACS, to be able to repay on time, and to use loans for business development. Not having access to loans at all or only from moneylenders for high interest rates, being over-indebted and not able to repay loans on time as well as borrowing for consumption purposes are the major constraints for a low ability to use loans.

ABILITY TO SAVE

The 'ability to save' has been mainly associated with households that deposit money in a bank, save regularly, save for emergencies and retirement, and for building assets. The ability to save in general received great attention by the participants of the FGDs and reflects high relevance as a supporting factor for financial capability. The only constraining factor seems to be not to save at all or only having very limited savings.

ABILITY TO USE INSURANCE

The 'ability to use insurance' has been mainly associated with life insurance for all family members, while life insurance cover for only one family member was seen as expressing low financial capability. The ability view suggests that these able households live in an environment where there are resources to insure all family members along with attitudes to cover all family members.

ABILITY TO COORDINATE WITHIN THE FAMILY

The ability to coordinate within the family has been associated with families in which all members have a voice, and decisions are made by taking into account the responsibilities and needs of all members. Violence of husbands against their wives was seen as a factor threatening this ability (see box 2). Additionally, the ability to maintain a small family was also seen as a sign for being financially capable. Small families are better able to manage and use money, as perceived by the participants.

ABILITY TO PARTICIPATE IN COMMUNITY LIFE

The 'ability to take part in community life' has been associated with the reputation, respect and dignity households enjoy. In other words, being able to participate in community life depends not only on personal attributes but also on how households are treated by other community members and how this affects their choices to interact with the community. Not being part of a community support network or not being respected in the community are the most critical constraining factors within this ability while helping others enables the ability and hence one's financial capability level.

BOX 2
VIOLENCE AND COORDINATION WITHIN THE FAMILY

At a very early stage in the study, statements regarding violence in the families attracted the interest of the researchers. When asked why someone is a good or bad money manager, some participants of the FGDs, mainly in Rajasthan,made statements referring to violence in the family (exclusively men against women). These statements included'fight in the house/household/family', 'Fight and beatings of wife', and'thrashes wife'. The participants assigned the lowest level of financial capability to all of these statements. They felt that this violence limits the women's ability to manage money and use financial services effectively.

This study, and its open FGD methodology, was not designed to reveal and discuss sensitive issues such as violence against women. Therefore, we assume that the relatively few statements made in this respect most probably do not reflect the full scale of the problem. But, this finding clearly indicates thatuneven relationship between men and women, in general, and oppression of women by men, are factors that negatively influence the ability to manage money and use financial services, and that measures aimed at increasing the financial capability of women necessarily need to be measures to empower their role in both the family and community.

Since this study does not allow assessing the significance of violence against women in the microfinance arena, GIZ has decided to carry out an additional and more focused study on this topic.

ABILITY TO USE ASSETS

The ‘ability to use assets’ has been associated with the ownership of houses, land, farming assets and household items. The focus is on ownership and usage. Households may own land that, however, may be patchy and small. Thus, the utility of this land for agriculture or as collateral for loans is limited. Another feature of this ability is that the ownership of a house directly affects well-being of a household. Living in a proper house affects the family’s health condition since its members are less prone to health risks than homeless people or people without access to safe drinking water and sanitation. This also strengthens other abilities such as being able to earn money and taking part in community life.

ABILITY TO GAIN KNOWLEDGE AND SKILLS

Levels of knowledge and skills are outcomes of investments into education and an environment conducive to learning. Households themselves determine how they are able to gain more knowledge and skills. Someone who is not educated will find it more difficult to gain financial knowledge and skills.

While parents may not have had the opportunity to go to school, their children’s education contributes to the household’s reading and writing abilities. The FGD participants regarded a good quality education for the next generation as the best use of money as we have seen in Figure 10 (Financial Capability Levels: ‘What Households Spend on’). Enabling their children to be educated thus is seen as having the highest value in terms of financial capability, as well as contributing to the financial capability of the children.

This ability to gain knowledge and skills is a core ability insofar as it significantly contributes to the development of most of the other abilities mentioned before. Education and literacy is reflected in what people know, e.g. interest rate calculation, financial services, budget planning and accounting for business and financial transactions such as in Self-Help Groups and cooperatives. Literacy and numeracy enable people to take up better paid work as well as to make their voice heard in the community, thereby enhancing their abilities to generate and manage money in beneficial ways.

3.4.1 Regional Variations in Key Abilities

The following section lays out what role abilities play in the concept of financial capability in the four different states where the study was conducted. Table 5 shows the relative share each ability has (in terms of quantity of statements relating to this ability) in the overall concept of financial capability in each state. We can see that preferences and priorities vary across the states.

In Karnataka the most relevant abilities that determine the local financial capability concept are: the ability to coordinate within the family, the ability to spend money responsibly/ wisely, the ability to generate sufficient income and the ability to save. These 4 abilities together represent more than 50% of all statements.

In Odisha the ability to generate sufficient income and the ability to use assets alone determine more than 50% of all statements. Other important abilities for the local concept are the ability to save and the ability to gain knowledge and skills.

In Rajasthan ‘the ability to spend money responsibly/ wisely’ contains the most statements, followed by the ability to use loans, the ability to save, and the ability to coordinate within the family.

In Uttarakhand the focus of the discussions has been, like in Odisha, on the ability to generate sufficient income. The ability to spend money responsibly/wisely, the ability to use loans, and the ability to save are the other preferences of the local participants.

Interestingly, the ability to save is among the highest priorities in each state. Yet, when looking at the total sample size, on notes that the ability to generate sufficient income comprises the most statements. This clearly reflects the need for a localized concept, reflecting priorities and perspectives of the local households.

TABLE 5
STATE-WISE FINANCIAL CAPABILITY CONCEPT [4]

DISTRIBUTION OF STATEMENTS PER ABILITY ACROSS DIFFERENT STATES					
ABILITY	KARNATAKA	ODISHA	RAJASTHAN	UTTARAKHAND	TOTAL
Ability to generate sufficient income	15%	31%	8%	20%	19%
Ability to spend money responsibly/ wisely	16%	9%	23%	15%	16%
Ability to handle money on a daily basis	2%	1%	5%	4%	3%
Ability to plan for the future	8%	1%	4%	2%	3%
Ability to invest	5%	2%	5%	5%	4%
Ability to use loans	3%	9%	16%	13%	10%
Ability to save	11%	10%	14%	10%	11%
Ability to use bank accounts	0%	0%	4%	7%	3%
Ability to use insurance	2%	0%	3%	4%	2%
Ability to coordinate within the family	20%	3%	12%	6%	10%
Ability to participate in community life	3%	4%	4%	6%	4%
Ability to use assets	7%	20%	3%	6%	9%
Ability to gain knowledge and skills	9%	10%	1%	2%	6%

4 Numbers depicted in the table have been rounded and may add up to slightly distinct sums than 100%.

LEVELS AND DEVELOPMENT OF FINANCIAL CAPABILITY

4

In the last chapter we illustrated the different topics and abilities which determine financial capability and described them across the five different capability levels. This chapter will look more closely into the household characteristics at each financial capability level, and identify the major differences between these levels. These differences indicate changes across levels, which can be interpreted as the process in which financial capability develops from one level to another: what skills, knowledge, and attitude, which part of the environment and what kind of behaviour changes, when the financial capability of a household increases?

4.1 Characteristics of Households at the Lowest Financial Capability Level

This description of households at the lowest financial capability level is based on the statements made in the FGDs. Rather than covering all statements mentioned for households at this level, we focus on the most salient household characteristics and the major constraints these households face in becoming financially capable as perceived by the participants.

Households at the lowest financial capability level are usually severely constrained in all abilities required for making informed financial choices, managing money effectively, and using financial services for their own benefit:

- Households at the lowest financial capability level have uneven income streams and *earn a very low income*. They are usually dependent on government support, daily wage work, or begging. If at all, they have one income source, and very few adult family members generate income. Some households even have to send their children to work to increase the family income. According to the FGD participants, these households manage their time poorly, and household members do not work hard enough. The latter may also imply lacking access to paid employment.
- *The ability to handle money* is also hardly developed in these households. They live "from hand to mouth" and use their little money on a daily basis without any planning and budgeting. Their very low income hardly allows developing financial management abilities.
- The households are often described as having a particularly low ability to *spend their money wisely*. They do not control their spending and often spend their money on things perceived as unnecessary, e.g. spending a high share of money on 'bad habits' such as alcohol and gambling. This situation reduces or even precludes spending on vital expenditure items such as food and school fees.
- The households' *ability to plan for the future* is severely restricted. They usually do not think about and discuss their future, and hence do not take future expenditures for life cycle events or emergencies into account. In fact, given their very low income and uneven income streams, there is hardly any potential for planning ahead and investing in the future.
- The households remain low levels in all abilities under the focal area 'using financial services': They usually *do not have bank accounts* and, if they do, they use them only for receiving government transfers. Reflecting their very low financial capacities and low ability to plan for the future, they are *hardly able to save*, lack insurance awareness and do not have any *insurance cover against their risks*. Most of these households have *no access to loans from formal sector sources*. Thus, they must revert to informal loans with high interest rates, which are often only provided against labour or jewellery mortgage. In general, loans are used for meeting daily needs. The ability to repay is low, which often results in borrowing for repaying debts, or defaults and loss of assets.
- Looking at the focal area 'using social capital, assets and competencies', we can see that the ability to participate in community life is often described with households lacking respect and reputation in their community. Their voices and opinions are not heard and valued by other community members. They usually cannot rely on support from other community members. There also seems to be little coordination, unity, and care of children which indicates a low ability to coordinate within the family. Adding to their strongly constraining environment, the households are often described as having many children and unhealthy family members, for whom additional expenditures for schooling, food and health services are required. Furthermore, they hardly own land and other assets such as a proper house, animals, vehicles and farming equipment.

Interdependency of Abilities

Participants in the FGDs associated the negative characteristics of abilities described above with households who cannot manage money well. These abilities may directly or indirectly (by affecting other abilities) influence financial behaviour; some do both as for example the lack of adequate housing: Having no permanent house or no assets that can be pledged can directly affect a household's access to financial services. And, an inadequate housing situation may also affect a family's health condition which results in higher health expenses and reduces the ability to work. The lack of social reputation and networks can influence the opportunity to work and generate income as well as the ability to access financial services.

Predominant statements describing households with low financial capability in terms of its community relations were: They have no voice, are dominated by upper class and caste, do not have social reputation and are cheated by people, they have no dignity at all in society. Social exclusion leaves little options to pick up employment or forces people to enter into exploitative economic relations. At the same time, these households may have only few productive assets and low levels of education. Hence, their ability to generate income is very limited. In sum, these constraints (lack of economic relations, lack of assets and no education) result in 'little and irregular income'. Where the education level is low and where only little and irregular income is earned, the abilities to plan for the future and to manage money well remain low. This is further constrained by the lack of family coordination, which was described as: having no unity, having many fights with the wife and others in the family, having no understanding, not having good intentions, lacking ambition, fear of losing, irresponsible, not sharing money.

Let us go back to the people we met in the introduction: Umesh's accident deprived him of his ability to earn income. But, his entrepreneurial attitude and skills along with support from his wife enabled him to build up a new business. At the same time, he was able to access and use a loan which helped him to finance the lease for the coconut orchard. Thus, the abilities to use competencies, coordinate in the family and to utilise loans offset the lacking ability to earn income after the accident. Mamta's ability to use a loan helped her husband to avoid migration. Migration of a family member constrains the ability to coordinate in the family. By enabling her husband to stay with the family, Mamta sustained this ability for her family.

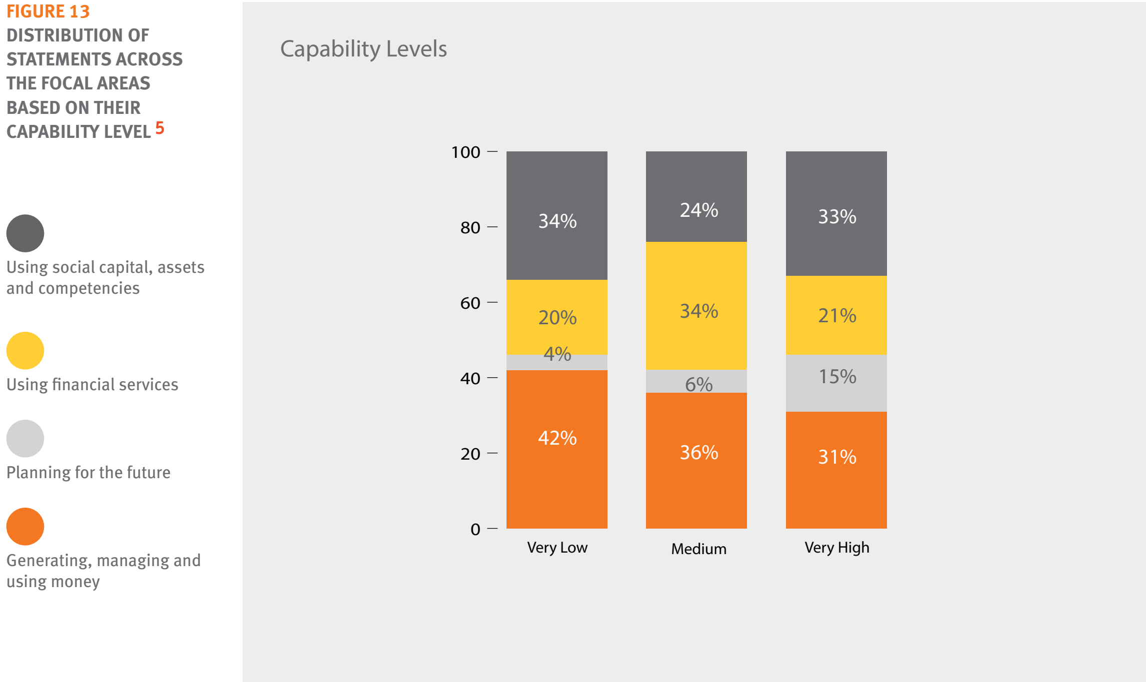
This shows that while households with a generally low financial capability level are constrained in many factors and abilities, there might be one or the other ability in which the household is strong and can build upon to improve other abilities as well as the overall financial capability level. This might be a personal ability based on knowledge or skills set or a chance or opportunity which comes up in the household's environment.

4.2 Changes across Financial Capability Levels

Looking at the frequency of focal area statements per capability level, it can be observed that the focus of households on issues related to generating and managing money decreases with increasing financial capability (figure 13). Vice versa, their focus on issues pertaining to planning for the future increases with increasing financial capability. Using financial services seems to be most relevant for households at the medium financial capability level, probably because low-level households do not expect to get access to financial services and high-level households feel no longer constrained in using financial services. There is almost no difference between low-level households and high-level households with respect to the use of social capital, assets and competencies. This may indicate that the thoughts of the first households revolve around the constraining factors, while those of the second households revolve around the enabling factors in this focal area of financial capability.

The next figures display the distribution of statements within each ability among the different capability levels (figure 14). These illustrations allow us to identify the abilities and related topics which seem to be rather constraining and those which seem to be enabling factors for the financial capability level of a household.

FIGURE 13
DISTRIBUTION OF STATEMENTS ACROSS THE FOCAL AREAS BASED ON THEIR CAPABILITY LEVEL [5]



Within the ability to spend money responsibly/ wisely there have been much more statements (35% of all statements relating to this ability) describing constraint levels of financial capability than supporting. This indicates the relevance a negative spending pattern of a household can have. The same can be found within the ability to use loans. Constraining factors play a much more important role (such as no access to loans, over indebtedness, untimely repayment, altogether 28%) than supporting elements. Also the ability to coordinate within the family is marked by a higher share of factors constraining the financial capability level (35%).

On the contrary, abilities like the ability to use insurance, the ability to save and use bank accounts, abilities relating to the planning for the future are dominated with enabling statements.

In order to gain more insight into what factors constrain or enable the development of financial capability, we will now describe how the main abilities, which were described by the FGD participants and identified in chapter 2, change across the financial capability levels 1) very low, 2) rather low, 3) medium, 4) rather high, and 5) very high.

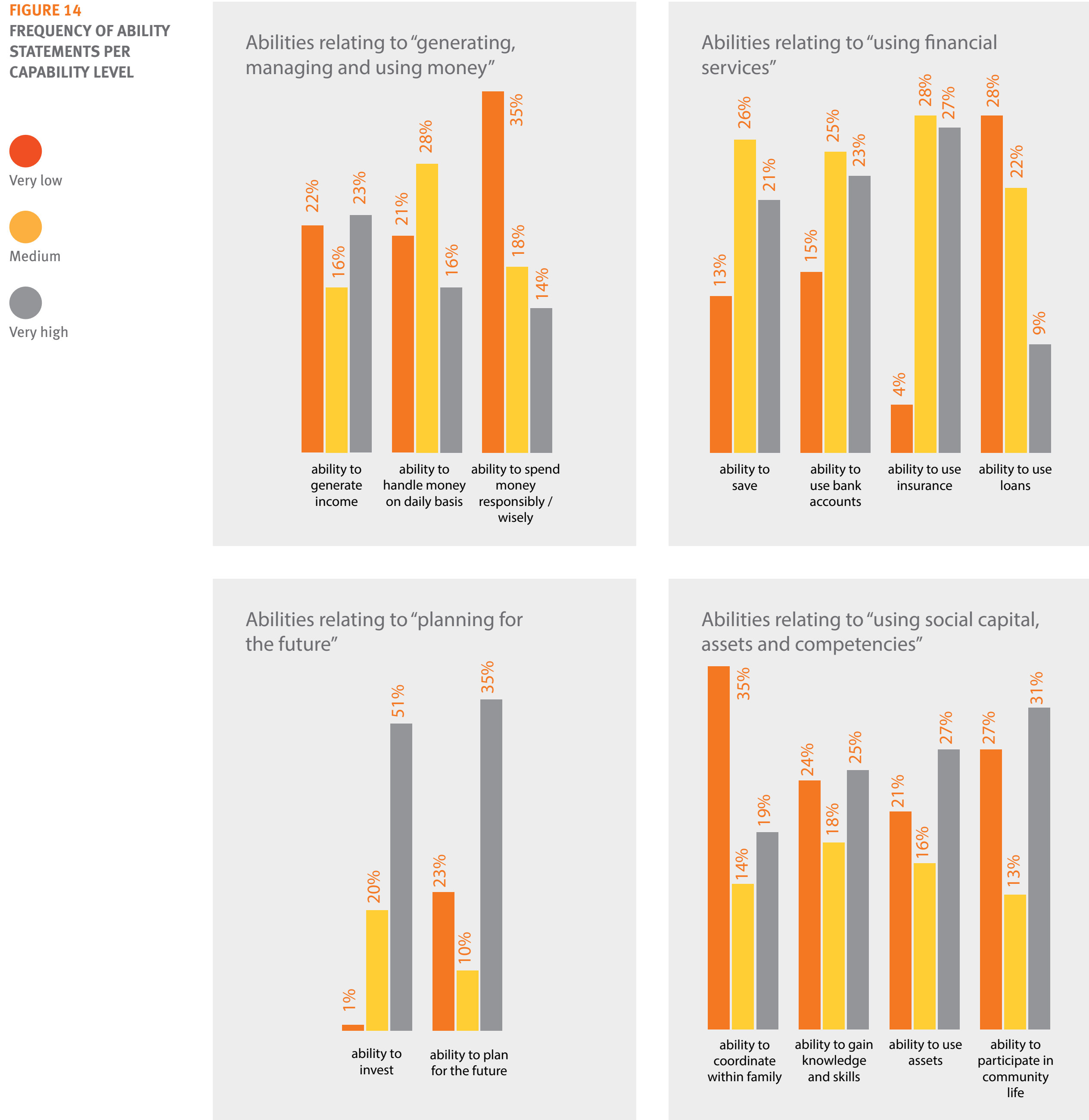
Changes from Capability Level 1 to Capability Level 2

The ability to generate sufficient income increases from level 1 to level 2 insofar as more income sources (usually two) are available. However, also at level 2 the household income is usually generated by only one adult family member, and children contribute in some cases. Daily wage work continues to be important, so that income streams remain uneven. New income sources at this level are labour migration, petty business and contract farming. Making use of additional job opportunities, these households are perceived as fairly hard working. While households at level 2 are still constrained in their spending ability, they start planning for the future, though this ability is still low and short-term oriented. They send their kids to government schools and spend money more carefully compared to Level 1 households. But, spending on vices continues to be a constraining factor.

The abilities which relate to using financial services increase insofar as households at Level 2 start having bank accounts. But, these accounts are usually only used for receiving government cash transfers. Their ability to use loans is limited to borrowing from moneylenders, friends and relatives. While their repayment capacity is still low, they seem to be less threatened by defaults and asset losses than Level 1 households. However, loans are still often used for repaying other loans, or for financing daily needs

5 For a better overview of the following figures only capability levels 1 (very low), 3 (medium) and 5 (very high) are being illustrated. Trends remain the same when including level 2 and 4 also. Numbers depicted in the graph have been rounded and may add up to slightly distinct sums than 100%.

FIGURE 14
FREQUENCY OF ABILITY STATEMENTS PER CAPABILITY LEVEL



and life cycle events, and hence do not contribute much to increasing income and assets. The households at Level 2 start saving small amounts occasionally, at home or with informal service providers. Their savings behaviour is usually short-term oriented and without a particular purpose. Like Level 1 households, these households lack insurance awareness, and they do not have access to or do not make use of insurance services.

Both Level 1 and Level 2 households lack social capital, with their community relations constraining rather than enabling their financial capability. Some households at Level 2 have been supported by the community, but in general the ability to participate in community life is only marginally improved compared to Level 1 households. The ability to coordinate within the family improves slightly and domestic violence seems to occur in fewer cases. While the family size is still large, the health situation of family members seems to improve. Households at both levels are below-poverty-line (BPL) card holders. Though more households at Level 2 live in a simple house, keep few animals and own land, land holdings and other assets are usually too small to add significantly to the family income. Also education and skill levels increase only slightly.

Changes from Capability Level 2 to Capability Level 3

The FGD participants referred to households at Level 3 as rural "middle class families", which have two or more income sources with both parents earning income, whereas children no longer work. Economic activities shift towards independent farming and additional own family business, though the development of non-agricultural income sources is still limited. Income streams become more even and the ability to generate sufficient income improves. While less land needs to be rented, these households depend on their own labour with a limited use of agricultural equipment. They are perceived as hard working, but unfavourable market prices for agricultural inputs may constrain their ability to generate sufficient income. Level 3 households are better able to plan and balance income and expenditure streams. Their abilities to handle money on a daily basis and to spend wisely improves, because household budgeting becomes more prevalent and expenditures become more focused on the consumption of good food and sending children to, partly private, schools. Based on this, also their ability to plan for the future improves and investment behaviour changes accordingly.

The use of financial services now becomes an important element of the household economy. Level 3 households have bank accounts, which are mainly used for savings purposes, and their dependence on money-lenders decreases significantly as they are members of SHGs and PACS and can borrow from them. Besides financing family events, loans are increasingly used for generating income and repayment capacity increases accordingly. The households' savings behaviour becomes more regular and aims more at building funds for future investments and emergencies. They start covering risks through insurance, mainly life insurance and usually limit the coverage to the male head of the family.

The households' social capital increases in terms of reputation and the ability to participate in community life. Social relations become an enabling rather than a constraining factor for financial capability. While family size decreases, also the ability to coordinate within the family improves. The size of land holdings (up to 3 acres) allows generating income from agriculture, the housing quality improves (most households have pucca (a Hindi term for solid, permanent) houses, and livestock such as bullocks add to the households' assets. The educational levels and labour skills of household members increase and give them more options to generate income.

Changes from Capability Level 3 to Capability Level 4

Households at capability Level 4 are able to generate income through regular salaried jobs, agriculture and shops, which allows them to sustain their families, and even to lease their land and lend money. They plan budgets to manage their cash flow on a daily basis, and spend their money prudently. They also exhibit a well- developed ability to plan for the future. They invest in the education of their children, new business opportunities, land and labour.

Level 4 households use bank accounts routinely and avail loans from PACS and banks. Bank loans are mainly used for investments and business expansion, and repaid on time. The households have a high propensity to save and use bank deposits for accumulating funds for future investments. They are aware of the functions and benefits of insurance, and more household risks are covered by insurance than in households with lower financial capability levels.

The households' social capital, in terms of their reputation and participation in community life, is high. They support the community and can draw on community support, and they are more influential in shaping community relations and affairs. The usually small families have high degrees of coordination, and women are much more involved in decision making. The families live in pucca houses, own up to 10 acres of land, and agriculture has a far higher degree of mechanisation than in lower-level households. The education levels of household members are relatively high and children are sent to private schools.

Changes from Capability Level 4 to Capability Level 5

As for Level 4 households, households at capability Level 5 have multiple income sources and smooth income streams. They own even larger hand holdings, but they are not anymore actively engaged in agriculture, and earn money from leasing their land holdings out or speculating with land. Knowledge of money management is highly developed, cash flows are well planned, and money is spent judiciously.

The households' ability to plan for the future is characterised by foresight and long term planning. They evaluate new business and investment opportunities, and they make high investments in business, land and labour, and the higher education of their children in cities or even abroad.

The households' ability to use financial services is very high. They have multiple bank accounts and, having high savings capacities and various forms of collateral, they have easy access to bank loans. Loans are mainly used for larger business investments. All household members are insured against various risks.

The social capital of these households is very high. Using this social capital does not only enable them to participate in community life, but also to actively shape this community life and structures. It is also converted into political influence, which extends beyond community and village boundaries. The FGD participants described these households as "truly powerful" and "business oriented", which implied both admiring (very high reputation) and dissociating connotations. Some of these households were described as greedy and lacking social responsibility for the weaker sections of the community.

4.3 Markers for the Development of Financial Capability

The description of how characteristics of the main abilities change across financial capability levels provides insights into factors that constrain or enable the development of financial capability. In the following table, these changes are summarised in the form of a financial capability matrix (table 6). This matrix can serve as a basis for further analysis, and finally help in the identification of interventions and tools aimed at supporting the development of financial capability development among rural low-income households. It can also support measuring the impact of interventions along the development of different abilities in a household.

The changing characteristics observed across financial capability levels must not be interpreted as a standard and linear development process, and not all characteristics mentioned for the highest capability level must be seen as objectives for all rural low-income houses.

The latter is due to fact that the FGDs described high financial capability households in terms of both characteristics resulting from financial capability and factors enabling to reach higher financial capability levels. This realistically reflects the interaction between causes and effects, action and conditions of action. For instance, certain abilities such as education and skills allow generating higher income, and vice versa, higher incomes allow developing certain abilities such as the abilities to save and invest. However, not all households will be able to or want to become absentee landlords or larger entrepreneurs with employees. Instead, and as expressed during the FGDs, many rural people highly value salaried jobs, which ensure even income streams and promise economic stability. Furthermore, the highest financial capability level includes the description of households which may not be seen as role models, at least not when certain abilities are used to dominate social relations, and impact other community members negatively.

The process of improving financial capability is a non-linear process and involves a variety of abilities which influence each other. Each household has its own characteristics, different combination of abilities, and different needs to improve specific abilities for reaching higher capability levels.

TABLE 6
FINANCIAL CAPABILITY MATRIX

FINANCIAL CAPABILITY MATRIX - MARKERS FOR THE DEVELOPMENT OF FINANCIAL CAPABILITY

ABILITY	Very Low Financial Capability LEVEL 1	Rather Low Financial Capability LEVEL 2	Medium Financial Capability LEVEL 3	Rather High Financial Capability LEVEL 4	Very High Financial Capability LEVEL 5
Ability to generate sufficient income	• Very low or no income • Engaged begging, daily wage work • Dependent on government support • Only one income source • Highly irregular income • One earning adult household member, children contribute	• Very low/low income • Engaged in petty business, contract farming, some migration and daily wage work • Two income sources • Irregular income • One earning adult household member, children contribute	• Sufficient income, middle income • Engaged in (petty) business, agriculture • Two or more income sources • Partly regular income • Two earning adult household members	• Fairly high income • Engaged in salaried jobs, own businesses, agriculture, moneylending • Multiple income sources • Regular income • Two or three earning adult household members	• High income • Engaged in salaried jobs, own businesses, moneylending • Multiple income sources • Regular income • Every adult in the household earns
Ability to spend money responsibly/ wisely	• Spends on alcohol, bad habits, irregular schooling and food • Spends unnecessary and unwise	• Spends on alcohol, partly sending children to government school • Try to control expenses, more careful spending	• Spends on good food, very little alcohol, children in government school and partly in private school • Spends less and wisely	• Spends on good schools and higher education • Spends money very carefully and buy in bulk	• Spends on good schools, high priority for education • Spends money judiciously and buys in bulk
Ability to handle money on a daily basis	• Daily earning, daily spending with acute shortages • No plans and budgets	• Daily earning, daily spending with shortages • Prepares plans but doesn't follow budget	• Manages balance between income and expenditure • Prepares plans and budgets	• Spends according to income • Uses plans and budgets	• Knows how to manage money • Uses plans and budgets
Ability to plan for the future	• No thinking and planning for the future	• No future plan	• Household plans for the future	• Has foresight and plans for the future	• Plans long term, for children and emergencies
Ability to invest	• Increasing income is no option • No investment	• No capacity to invest • No investment	• Thinks of increasing incomes • Invests in business	• Thinks of new businesses • Invests in business, employment (of others), land	• Actively seeks new investment opportunities • Invests in business, houses, labour, land
Ability to use loans	• No access to formal loans, borrows from moneylenders, pays high interest rates • Does not repay, sells property to repay • Uses loans to repay other loans, for daily needs	• Has no access to formal loans, borrows from moneylenders and other informal sources • Does not repay, repays with high difficulty • Uses loans for lifecycle needs, sometimes daily needs	• Has access to loans, borrows from PACS, SHGs, community • Is creditworthy, repays loans on time • Uses loans for productive purposes and big events	• Has easy access to loans from banks and PACSs • Repays loans on time • Uses loans for business and investment	• Has easy access to loans from various sources such as banks and PACS • Repays loans on time • Uses loans for business and investment
Ability to save	• Does not save and has no savings	• Has small savings, saves very little • Saves irregularly, not in banks	• Has some amount of savings • Saves regularly in SHGs and banks and has practice of saving • Uses savings for the future and emergencies	• Has large amount of savings • Saves regularly and in banks • Uses savings to build assets	• Has a large amount of savings • Saves regularly and in banks • Uses savings for emergencies, retirement and to build assets
Ability to use bank accounts	• Has no bank account, if so then for MNREGA	• Partly, has bank accounts	• Has a bank account	• Has a bank account	• Has multiple bank accounts
Ability to use insurance	• Lack of awareness • No insurance cover	• Has no insurance	• Has insurance cover for one (male) person	• Has insurance cover for many family members	• Has insurance cover for all family members
Ability to coordinate within the family	• Has no unity, there is violence and carelessness • Has a large family, unhealthy	• Has some coordination among the family • Has a large family	• Has coordination and responsibility among the family • Has a large to mid-size family	• Has unity in the family and good coordination among the family • Has a small family size	• Has unity in the family and good coordination among the family members • Has a small family size
Ability to participate in community life	• Has no reputation, no support, it is voiceless	• Has no reputation, it is voiceless	• Has reputation, they help others	• Has good reputation and support, contacts, they help others	• Has good reputation, influence in the community
Ability to use assets	• Has no property, no land • Owns no other assets • They are homeless, or live in rented houses or shacks	• Has very little land • Owns very few animals • Has a small house	• Has some land (up to 3 acres) • Owns bullocks and household items • Has a pucca house	• Has a lot of land (up to 10 acres) and landed property • Owns tractors and power tillers • Has a pucca house	• Has a lot of land and landed property • Owns motor vehicles, tractors and other equipment • Has a good house
Ability to gain knowledge and skills	• Has no education, no knowledge, no literacy	• Has no education	• Is educated, they are skilled labourers	• Is well educated and has knowledge	• Is well educated and possesses special skills

SUMMARY & CONCLUSIONS 5

Summary

Understanding the use of money and financial services has received little attention in the public debate and development of financial systems for low income rural households in India. From policy makers to development organizations, from banks to NGOs, the focus is often on financial access, financial literacy and financial education as a means to financial sector development. This is expected to impact the people and to enable them to improve their lives. A focus on what people are able to do with money and financial services, how they can act and actively shape their lives using money and financial services is missing. There is a large gap of knowledge of how people can use and manage money and financial services to their own benefit.

This study set out to explore what financial capability means for low income rural household in India. Financial capability in this context is defined as the ***ensemble of abilities*** related to making informed financial choices, managing money effectively, and using financial services for one's own benefit.

An important methodological characteristic of the study is the starting point of capturing the perspectives of the households themselves and their perceptions of financial capability. The research questions were open to enable genuine discussions and they were aimed at understanding how people act when using and managing money.

The study was conducted in four states of India (Rajasthan, Karnataka, Odisha, and Uttarakhand) to cover the four major regions of India. In these states 96 Focus Group Discussions with users of microfinance services and financially excluded households were conducted.

In an open coding process the research team processed the 3,399 statements provided by the study participants during the Focus Group Discussions. Iterative processes of analysis of these statements led to the conceptualization of perspectives into four focal areas: ***'generating, managing and using money', 'planning for the future', 'using financial services' and 'using social capital, assets and competencies'***. While the first three describe basic financial functions which households perform, the last focal area covers statements which relate to the physical and social environment in which households act and to competencies they draw on when acting.

The framework of financial capability, as described by the participants, consists of 13 abilities which are interlinked with each other, but need to be seen separately to better understand the financial capability concept: Financially capable households are able to *(1) generate sufficient income, (2) spend wisely and responsibly, (3) manage their daily cash flows, (4) plan for the future, (5) invest, (6) save, (7) use bank accounts, (8) use insurance, (9) use loans, (10) coordinate within the family, (11) participate in community life, (12) use assets, and (13) gain knowledge and skills*. Households at the lowest financial capability level are usually severely constrained in all abilities required for making informed financial choices, managing money effectively, and using financial services for their own benefit. While during the Focus Group Discussions participants associated their statements with 5 different levels of financial capability (very low, low, medium, high and very high), we can now see the change of characteristics within each ability from a lower financial capability level to a higher one. This helps in describing the change process households are facing when increasing their individual financial capability level. This complexity is visualized in the Financial Capability Matrix.

Recommendations and Next Steps

The objective of the financial capability concept is to make financial inclusion more impactful for low income rural households. It aims at enabling the households to use financial services in a way that they benefit from them. Hence, financial inclusion needs be understood as a people-centred concept in order to make a positive impact. Financial capability is the framework which specifically shows how people choose, use and manage money.

In order to apply this thinking, stakeholders (government, financial service providers, and development agencies) need to start focussing on the quality and impact of financial services along with the quantity and numbers (of accounts, clients, etc.). As we have seen throughout the process of this research, it is not only the access to financial services or the knowledge about these services which are important, but the actual financial behaviour which is affected by a range of social, personal and environmental aspects as well. Local preference, priorities and perspective are hence of crucial importance. Only if we focus on the complete ensemble of the identified abilities and their characteristics, we will be able to make a difference to the rural low-income households. Interventions for many of the abilities are often out of the focus and mandate of practitioners in the financial inclusion sphere. They would require collaborations with other stakeholders and partners in order to really change the abilities. The below mentioned recommendations provide intervention areas which are in the limit of many of the stakeholders and hence can be seen as good starting points.

Recommendations: Five Strategic Intervention Areas

As a tentative conclusion, the preceding analysis points to the need for increasing the financial awareness and literacy of rural low-income households as well as to five strategic intervention areas for developing the financial capability of these households:

1. Supporting the self-organisation of low-income people in Self-Help Groups, cooperatives and other forms of mutual organisation. This increases their social capital and improves their ability to participate in community life as well as their ability to gain access to certain financial and non-financial services.

2. Supporting the empowerment of women through self-organisation and other means. This will not only contribute to gender mainstreaming, but may also be an essential condition for improving the coordination and decision making within the family as well as for promoting the responsible money management of low-income households.

3. Supporting low-income households in acquiring specific knowledge and skills required for managing the household economy, for planning and monitoring household budgets, and for making longer-term plans aimed at improving their social and economic stability.

4. Supporting the development of livelihood opportunities, which reflect local potentials as well as the abilities and preferences of the households and their members. As many low-income people have a preference for salaried jobs with even income streams, this should include the development of skills in line with the demand of labour markets.

5. Working from both sides of meaningful and sustainable financial inclusion: i) by supporting efforts to improve the financial awareness and literacy of low-income people, and ii) expanding their access to needs-based and demand-oriented financial services. Low-income people have need for a wide range of financial products rather than credit alone. Appropriate loan products should be available for a variety of purposes, including education and skill development.

Next Steps

This report only reflects a brief exploration into this complex topic, but we sincerely hope that it will start making stakeholders think and hopefully even act in light of impact and quality of financial inclusion strategies. We, as GIZ, will contribute more inputs into this concept within the next months. Some of our next steps are:

- We will develop a questionnaire which aims at measuring the actual financial capability levels of the households who also participated in this study. This will show us how the abilities as defined by the participants are developed across the households in the same districts.
- Further research especially on the correlation between different abilities and how they impact and influence each other will be conducted.
- A financial capability toolbox will be developed which will enable stakeholders to better understand and implement the concept among their target groups. The toolbox will contain a variety of tools especially targeting at stakeholders active in the rural financial sector in India.
- In order to promote the financial capability concept and toolbox, GIZ is conducting a road show throughout India reaching out to a variety of stakeholders. This road show, in the form of workshops and events in all the major regions of the country will bring together stakeholders from the government, financial and development sector.

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