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FSD Insights

FINANCIAL CAPABILITY AND THE POOR: ARE WE MISSING THE MARK?

As branchless banking and other efforts to increase financial inclusion extend the financial access frontier outward, the newly banked are exposed to both new opportunities as well as new risks. Financial capability is a term heavily burdened with the task of both mitigating those risks and maximizing opportunities. We often assume that financial capability must be strengthened in order to drive uptake of new services, improve the impact of services on consumers, ensure consumer protection, and make financial markets more efficient information processors.

But are we sure that a single concept can indeed fill all these functions in one fell swoop? Financial capability has been taken to mean so many things: knowledge and understanding of formal financial products and systems; familiarity with formal financial services; confidence to use new services, ask questions, and seek redress; skill to manage credit; and ability to plan ahead and budget (World Bank 2009; Vitt et al 2005; Atkinson et al 2006). Is there is a particular part of financial capability that might be more powerful than others in advancing financial inclusion while protecting consumers?

To better unpack and understand how financial capability interacts with financial management, we turned to consumers, seeking their descriptions of financial capability as a lived experience. We spoke to Kenyans, who, for many, had their first engagement with formal financial services through M-PESA. Over the course of July 2010, we conducted 50 in depth interviews in Coast Province with consumers representing a wide range of experiences using formal and informal financial services. A link to the research methodology and research details is provided at the end of this publication.

Data captured in these interviews challenges our basic understanding of financial capability, splintering multiple, fundamental and implicit assumptions about the role of financial capability in financial inclusion. Respondents told us that, in their context of uncertain, uneven, and insufficient cash flows, financial capability means something very different than it does in advanced economies where cash flows from jobs, safety nets, and investments are more predictable and stable. Kenyan consumers' experiences in managing their money call us to take a step back and consider alternative approaches to financial capability, particularly in an environment markedly changed by branchless banking.

Splintered assumption 1: Financial capability can be measured in part by whether and how an individual uses formal financial instruments

Studies done in a developed world context have documented a correlation between financial literacy and usage of formal financial services, including banking and the stock market (Van Rooij et al 2007; Hogarth et al 1999). With this knowledge as a base, many researchers, organizations, governments and commentators have implicitly assumed that this relationship holds for even basic financial services in developing countries, meaning that financial illiteracy may inhibit financial inclusion (Cole et al 2009; OECD 2008; Sridhart 2010; African Development Bank 2009).[1]

Earning and allocating funds is a seamless, continuous process

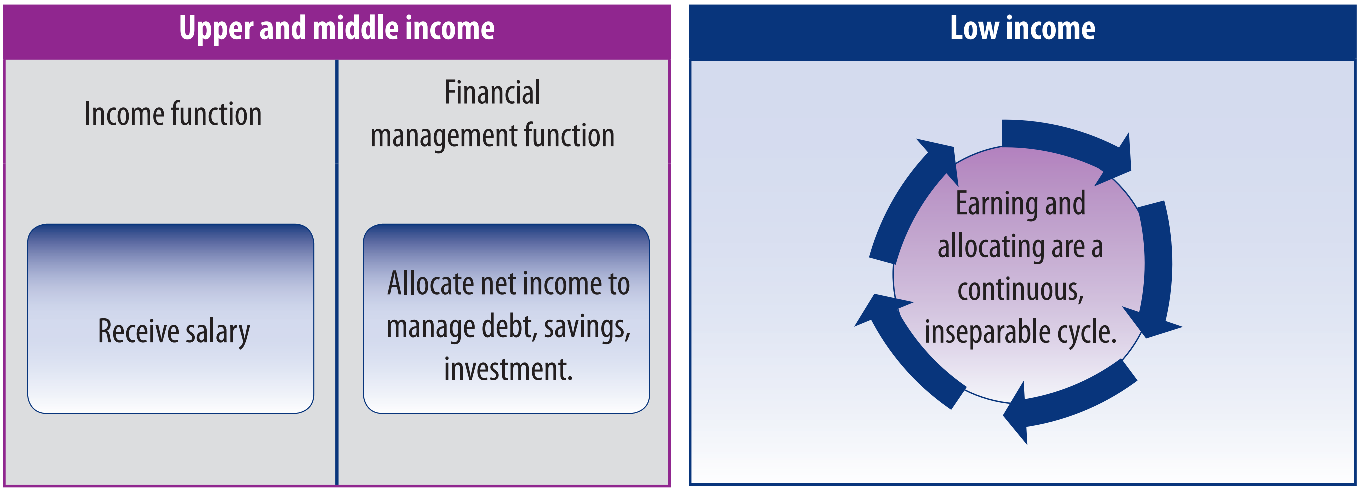
However, we observe that when the poor talk about financial capability, they associate it, not with allocating funds into financial investments, but instead with generating income. They are concerned about using loans and savings to make investments in business opportunities to boost overall family income. We spoke to Kenyan respondents from all walks of life - including the relatively well-off - and they all emphasized the importance of planning for investment to "develop yourself" and "progress" by, for example buying a motorcycle taxi, building rental houses in a town, or starting an additional business. For all Kenyans, the primary financial management concern is continuing to generate greater and more stable cash flows amidst significant uncertainty. The poor live on the margins and inflows are highly unpredictable. But even the seemingly well-off feel the pinch of job and economic uncertainty and the pressure to generate greater incomes for themselves and their extended families.

Even those with salaries have businesses that they are running on the side for themselves or for their extended families. An urban soldier explained, *"You see, as Kenyans, we cannot rely only on our salaries, and here you can engage in other means of earning income just to meet your daily bread."* As small business cash flows are not as orderly as salary income, financial management becomes part and parcel of managing and building these continuous cash flows.

In short, in advanced economies, financial management is about allocation of regular cash flows into investments and debts of varying risk/return and maturity profiles to cover a family's lifetime of financial needs. In the Kenyan

[1] Cole, Sampson, and Zia (2009) conduct a field experiment to test this common assumption; Indonesia declared 2008 the "year of financial education," and purposely set out to increase financial inclusion via financial literacy. http://www.oecd.org/document/3/0,3343,en_2649_34853_40660803_1_1_1_1,00.html; India's Finance Minister has also cited financial literacy as a cornerstone of inclusion http://www.thehindu.com/business/article267686.ece; The African Development Bank hosted a conference in 2009 called "Promoting Financial Capability and Consumer Protection - A Step Forward Towards Financial Inclusion in Africa" http://www.afdb.org/en/news-events/article/conference-on-promoting-financial-capability-and-consumer-protection-a-step-forward-towards-financial-inclusion-in-africa-4979/.

Figure 1: Financial management functions differ depending on cash flows



economy, financial management is a constant, inseparable cycle of earning and allocating uncertain, erratic cash flows.[2]

This puts discipline and commitment at the heart of being a good manager…and a good person

An important implication of this is the following: working to meet long term goals in the face of erratic cash flows means that *discipline* - and its correlate, *commitment* - are perpetually in the forefront of consumers' minds. They are balancing the need to keep liquidity close enough for emergencies, but far enough away to not spend it easily. Cash flows are continuous and often on hand. Consumption is a constant temptation and for those earning only just enough to survive, the discipline of saving for tomorrow comes with the cost of hunger today.

For those who live particularly close to their cash flow margin, the restraint needed to save and invest involves forgoing necessary consumption. Two respondents made this understanding very stark. We conducted an interview with two rural women, both of the same age, both widowed with 3-4 children, both working as casual laborers hauling water or working in the fields of wealthier neighbours. The first woman was unable to send any of her three children to secondary school. She belongs to one savings group, but confided, *"When I get money, I eat!"*

Her friend, emaciated and disappearing beneath her oversized sweatshirt, glows talking about putting her two oldest children through secondary school and preparing for the last two to enter. Until a recent emergency surgery drained her resources, she belonged to *eight* savings groups helping her scuttle away small sums almost daily. When asked how she was able to send her children to school, she explained that sometimes her children eat, and she goes to bed hungry. For her, investing in the future means serious sacrifices today, and commitment devices play a major role in helping her stay on track with her goal of educating her children.

In the face of such serious sacrifice, it makes sense that poor money management is associated in consumers' minds with a lack of virtue. When asked about bad money managers they know, every single respondent from every strata of access pointed to someone who indulges in excess leisure or impulse spending. Poor money managers waste money on alcohol, drugs, extramarital affairs, and purposeless travel. They cannot stretch their money far enough to meet their families' basic needs and end up chronically begging to make ends meet.

> A rural woman with a small fried-dough business explained that those who have trouble managing money, *"spend their money aimlessly...they spend it on their girlfriend who demands a lot of money all the time or buy things on impulse without budgeting."*
>
> An urban building contractor agreed, *"Some are used to misusing the money. . . Maybe someone is paid 300 shillings. So you might get someone spending a hundred shillings as lunch then after job they go to the bar to take a beer or two so they end up with nothing for that day. So I take it they are misusing."*
>
> A rural teacher told us about the worst money manager she knows: *"My brother earns a lot of money but just around mid-month he is just begging people for money, simply because he has no money and he is a drunkard, and when he gets money he takes women out and buys good clothes for himself and enjoys."*

[2] The differences we observe seem to go beyond the level of *household income* and include wider economic variables impacting *expectations about the future*, such that it may be that the distinctions in financial management tasks vary by *economy* more than *household*.

Money management is steeped in virtue. Those who move ahead in the community are revered, often respected as leaders, less for their savvy use of financial instruments and successful investments, than for their being successful in avoiding vice.

So, consumers leverage specific financial devices to aid discipline.

This discipline is important not just for smoothing consumption, but also for saving for medium and long term needs, most notably emergencies and children's educations. On average among the 25 respondents for whom we built a cash flow statement, people were saving roughly 30% of all income, which is quite significant. Savings seems ingrained in cultural mores. When asked about proverbs relating to money management, nearly all participants recalled lessons about saving. For example:

> *"Haba na haba hujaza kibaba."*
> Saving small-small will fill the container.

> *"Akiba haiozi."*
> Savings don't rot.

> *"Ukipata shilingi mbili kula moja weka moja."*
> When you get two shillings, save one and eat one.

Given respondents' preoccupation with discipline and restraint, it is unsurprising that they reported using savings instruments - M-PESA, savings groups, and banks - to impose discipline on themselves. For low income Kenyans, M-PESA seems to hit that sweet spot for savings that it keeps funds close enough to use in an emergency, but also imposes a cost on withdrawals that serves as an effective commitment feature preventing haphazard withdrawal for consumption spending. A few small business operators earning cash on a daily basis reported making daily deposits to quickly get the cash out of their hands. Those with higher, more regular incomes felt the opposite: money on the phone was too easy to spend, particularly on careless topping up of airtime. To stop themselves from overspending on airtime, some of these respondents have decided to leave their M-PESA SIM card at home or never carry a balance. Instead, they tend to use bank accounts to impose greater spending discipline.

At least 14 out of 50 respondents, without prompting, mentioned the important role M-PESA plays in helping them cope with emergencies. Many keep a balance of Ksh500-3000 (US$6.50-$39)[3] in order to have cash on hand quickly in the event of a crisis. They withdraw funds to take care of a problem, buy airtime to make urgent calls, send money to relatives in crisis, and use the service to receive help from their wider networks:

> *"At night if you need to urgently make a call you can buy airtime from M-PESA."*

> *"It helps them because during emergency it is easy to get assistance. You don't need to travel to Mombasa or Malindi, you will just go to M-PESA and send money home say if your daughter was unwell, and they will be sorted."*

> *"I am staying here and my parents are far, and even now if they tell me they have a problem, and if there is money in my phone here it is very easy to transact money to them."*

When it comes to the choice of whether or not to use a bank as opposed to M-PESA[4] for savings, we find, that uptake is more a function of the attractiveness of an institution's products - including features that help consumers reach their goals, convenience, and cost - than of knowledge, familiarity, confidence, or other traditionally-recognized aspects of financial capability. Those without accounts complained of the long distances of banks from their residence or that they did not have enough money to save regularly to make banking an attractive value proposition. About 2/3 of all those with bank or SACCO accounts in our study opened their account because they were required to do so in order to receive their wages.

Savings groups and informal insurance groups were used by 30 out of 50 respondents. We observed that those with bank accounts were likely to also be members of groups. Instead, when respondents have greater access to instruments, they use more of them in order to take advantage of the different benefits of each. Savings groups remain a significant part of their portfolios, because they are commitment devices, helping people save more over longer periods of time, reinforcing members' planning, forcing them to postpone some expenditures and to think about future investments when they will receive their lump sum.

When we asked savings group members whether groups helped them save better, they told us:

> *"Yes, they help. You have an account, and you cannot easily access your money and so by that you will be economizing to take your savings to the group. It is like you have an obligation."*

> *"Normally people plan on what to do with their money [when it's their turn in the merry-go-round], and if you feel like you are not ready then you save. If you keep it in the house you will misuse it. We normally sit down, my wife and I, and think of a project or whatever we need to do and the rest we save or you can also reinvest it back to the group."*

> *"We call them 'chamas.' When it is your turn to be given the money you have to plan on how to use the money and most of the times you use that money for what you had planned for."*

[3] At the time of this study, the exchange rate was US$1=Ksh77.

[4] Our respondents tended to view M-PESA and banks as substitutes, whereas savings groups were viewed as a complement rather than a substitute to either.

Several respondents also reported that groups provided less tangible benefits, including providing one another advice. One urban woman belongs to a group called "Be Independent," where she enjoys meeting and saving with those "more advanced in life" to learn from their financial choices. Similarly, another woman enjoys the groups because there women "put their heads together" and support each other. The nature and quality of "advice" that some members report is not clear. Is it merely encouragement, or do they exchange more complex ideas about experiences with savings instruments and investments and help each other carefully think through financial decisions? In other words, while savings groups do seem to reinforce commitment, the mechanisms through which they do so are not entirely clear. It could be that merely having the meetings forces space into members' schedules to think about their financial goals, that knowing your peers are relying on you to save helps keep people's goals on track, or perhaps there is another level of experience and advice sharing that also helps people make better decisions.

In summary, for Kenyan consumers, financial capability has less to do with using formal financial services and more to do with optimising spending and investment amidst uncertain and erratic cash flows. Financial services can be an important part of these efforts, particularly if they help to reinforce the discipline the poor need to forgo some consumption now so as to meet future needs and achieve investment goals.

Splintered Assumption 2: Financial education precedes and induces uptake of financial services

As a correlate to Assumption 1, there is an implicit assumption of a causal chain (Figure 2 below), in which financial education leads to financial capability, which results in uptake of new services (Cole et al 2009[5]). In other words, it is new knowledge that drives demand for services. Much of the financial education literature explicitly states that ownership of a savings account is a desired behavioural outcome of financial education activities (OECD 2005; Kempson 2006[6]). Financial illiteracy is implicitly presented as a barrier to usage of mobile banking systems, because potential users are unfamiliar with formal financial services, don't fully understand the technology, and distrust branchless channels. The assumption is that increased understanding and comfort will drive uptake.

Instead, our interviews revealed that experience, rather than education, is at the core of improvements in financial capability, and, that experience includes actual usage of financial products, even before they are fully understood. Our respondents cited life experiences, particularly negative experiences, as how they learn.

One remarkable rural woman who pieced together a robust portfolio of income generating activities, including raising dairy cows, raising poultry, and selling potable water, recounted when we asked her how she learned to plan:

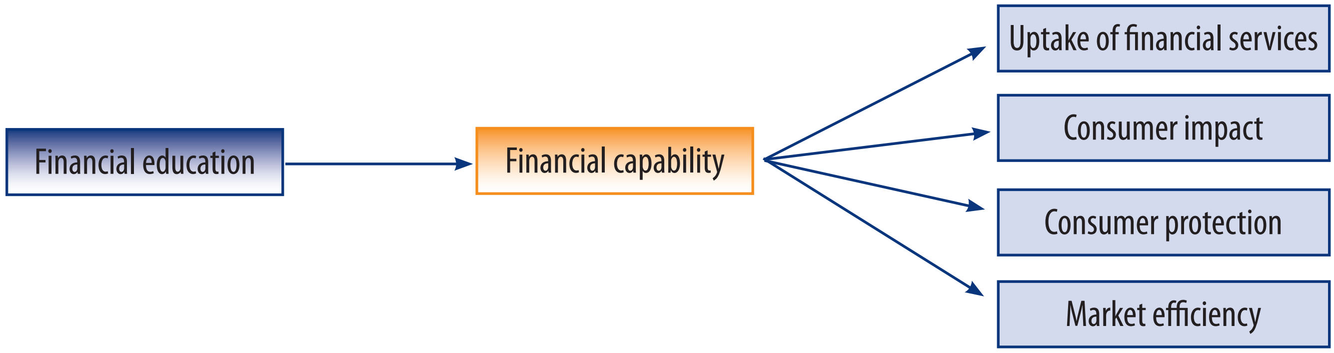
> *"At times you learn after experiencing some problems."*

When we asked what kind of problems, she explained:

> *"I could not afford educating my kids. My husband used to go away for even a month and the kids had no books, no pencils and I had to dig for other people [work in their farms], sell fish; I did literally everything to fend for my kids until my mind opened up and I started the projects."*

Respondents mentioned learning not just through their own life experiences, but by watching others. They imitate positive behaviours and try to avoid destructive ones.

Figure 2: Implied financial capability causal chain



[5] In this paper, the authors test this implicit causal chain by seeing whether a certain type of financial education or financial incentives are more effective in driving uptake of services. They find financial incentives more effective, but the logic of the hypothesis is based on the assumption of this implied causal chain, which itself may be flawed.

[6] Kempson (2006) suggests that a significant number of the unbanked self-exclude from banking services because of a belief that banking services are not meant for people like them and that familiarity and promotion of banking services can counteract this effect.

One very successful rural money manager formed a group of women that saved up together to buy each other dairy cows. After 17 years, the group is still going strong, the women continue to earn revenue from milk sales, and they believe their children are healthier from drinking more milk.

> *"I learn through experience and other people's mistakes, like when you see your friend who had money go to waste and their life deteriorating."*

> *"Sometimes you can imitate people and sometimes you learn through your own problems. Sometimes you suffer for a long period of time, so when you get a good job or good money you try to budget well."*

> *"At times you learn from your friends and how they are developing, and if you felt that you were not progressing well then you might copy them or ask them how they managed to be where they are."*

Two respondents talked about the way their families helped them to build financial management skills through both teaching and practice. One young man talked about his parents entrusting him with increasingly large amounts of funds to practice money management:

> *"I remember when I was in school my parents used to give me money to buy, like, story books, but I used to save money. . . Some can be trained on how to manage and can improve. Maybe the parents are going away and they give the child Ksh100 and tell the person to buy certain things. For such a person that time, they have to be told what to buy, but for me they, just can leave the money, and I will know how to use it."*

People cited learning from watching a broad range of friends, neighbours, family members and acquaintances to learn fairly big-picture lessons about being thrifty and making forward-looking investments. But, for more detailed advice about new products and more nuanced decisions, they looked to the experiences of closer relatives and friends, including spouses, parents and "mentors." One fairly well educated urbanite referred explicitly to seeking a guide, a "mentor" to help him make better financial - particularly investment decisions:

> *"Yes I do have many mentors they manage their money well and they do have alternative means of income. . . Especially the issue of investments, you see to get money is one thing and then there is to lose, so unless you put it into investments in terms of real estate investments, commercial vehicles and the likes."*

Consumers also rely on experience for learning to navigate new financial products. They report testing new services to make sure they work according to their understanding before increasing the value entrusted in that device. For example, one rural woman was very nervous the first time she opened a bank account, so she decided to test it a bit:

> *"I had saved 10,000, but I went back in two days to check and withdraw 2,000. I was told the balance was 7,970, because I was charged 30 for withdrawal. Once I was assured of that, I felt good, because I knew that they were genuine, and so I continued saving."*

Similarly, many reported starting to use M-PESA with just a very low balance. They checked soon after to see that their balance remained, and often sent small values to friends and family just as a test run of the service. An urban young man told us how he registered and went straight home to test it by sending a small amount of money to his wife while both sat together on the couch. It appears that M-PESA has been so widely accepted because people were able to try it and see that it worked instantaneously, reinforcing their trust with each transaction so that they develop comfort using it to store and send increasingly large sums of money.

They also reported learning from negative experiences with financial products. Many who have used banks in the past learned about minimum balances, regular deposit requirements, and transaction fees only by painful losses and shock upon checking their balances. A small business owner described her experience:

> *"There was a time I stayed for some time without depositing some money, and when I went there I found that some money had been deducted from my account. That is when I decided to close down that account. I had left my account with Ksh5000 but when I went there I only found some Ksh2500. [She asked the bank about the deduction.]. . . They told me that they only deduct from your account if you do not deposit."*

Like the respondent above, many respondents seem to be pretty harsh about changing behaviour after one bad experience where they were not able to seek redress. In most cases, respondents would stick with a service, even after a negative experience, if they were able to get clear answers to their questions. For example, some bank users reported being shocked by fees on a statement, but were willing to stay with banks generally after the fee structures were explained, though some moved to cheaper providers. But, they judged MFIs much more harshly than banks, demonstrating some continuing misunderstanding about the joint liability mechanism. Generally, a bad experience or loss experienced in an informal savings group does not drive members away from the group, but it is impossible to tell from this small sample whether that decision is based on the lack of alternatives, rational cost/benefit analysis, or whether such informal instruments are just excused from the type of scrutiny and expectations placed on formal providers.

Conversely, respondents report saving and sending greater values on M-PESA after successfully trying it out with small values first. Clearly, transparency goes a long way to building consumer trust and retaining clients, even if they are not completely satisfied with the cost of the service.

People do say that reading, writing, and arithmetic help with financial management, but these were not mentioned unprompted. For the aspects of financial capability they care about most, these are not primary skills.

> *"[Literacy] is not important. As long as you use your brain, you can manage your money."*

> *"[Literacy] is not a must, because there could be someone who knows how to read and write but they don't know how to manage their money and on the other hand there could be someone who doesn't know how to read and write at all but they are very good at managing their money."*

When literacy and numeracy were considered important, it was generally in the sense that these skills help a person to avoid being cheated or tricked.

> *"[Literacy] helps you in your future life…someone will not steal from you easily. For example the way you came here and asked me to sign [a consent form]. If I was signing for something that I didn't know then I can sign for something wrong, or you could be buying me and I don't know."*

> *"If I have that [numeracy] it will assist me so that I am not conned or stolen from when I don't understand."*

[Talking about those who can't read and operate their phones very well] *"Some men are conned and don't even know how to load airtime. There was a man who had credit of two hundred and he bought additional credit of a hundred and asked another gentleman to load for him, and instead of the man loading the airtime to his phone he was loading to his own phone."*

Our respondents had little exposure to formal financial education, but did consider product sensitisation conducted by loan officers as a helpful way to learn how to manage formal credit:

> *"I have never seen [someone struggle with debt], because one is already acquainted. When you get a loan from the co-operative bank or any other source, before you get that money you are educated on how to spend that income."*

In short, Kenyan consumers prioritise experience over education in strengthening financial capability. Low uptake of basic formal financial services seems to be driven not by lack of education and understanding, but by the mismatch between the product's features and clients' needs.

Splintered Assumption 3: Branchless banking poses more consumer risks than traditional banking, because agents are less accountable and users are less financially capable

Fears are often stated that branchless banking is dangerous for vulnerable customers. Agents may not be closely supervised, and unsophisticated consumers may be unfamiliar with channels for seeking redress (Dias and McKee 2010[7]; Reserve Bank of India 2010[8]).

An M-PESA agent tends to her clients with her agent number. Policies and prices are clearly and simply displayed for customers' view.

[7] In this Focus Note, Dias and McKee react to the concerns about branchless banking expressed by regulators and supervisors.

[8] The Reserve Bank of India's new business correspondent guidelines reveal a concern that agents must be closely supervised by banks (agents must be no farther than 30km from the nearest branch) and that extensive consumer protection measures are needed, including local language "attitudinal orientation" for agents, consumer financial education, and "social audits" to be conducted of BCs by communities.

This was clearly not the case in Kenya. Our respondents sought out agents they could trust. They knew where to seek redress, either from any number of agents or by calling Safaricom directly. One woman when asked whether she was nervous using M-PESA for the first time replied clearly, *"No. I was not scared, as some other people had used it, and I can get agents anywhere, anytime."*

Consumers were unafraid of asking questions and seeking answers, and reported elaborate stories for seeking redress after every negative experience with a financial service provider.[9] In fact, consumers seemed to believe that M-PESA agents were just as or more helpful than bank tellers, since you can ask your questions more quickly, and agents are not too hurried to move on to the next person in a long queue of waiting customers. Consumers felt banks were usually more able to rectify problems, but were generally less accessible.[10]

A small MFI in Mtwapa also serves as an M-PESA agent.

In Kenya, our discussions with consumers suggest we ought to be much more concerned with consumer protection issues around credit products rather than branchless channels. Our respondents welcomed access to credit - regardless of interest rate - and in fact paid very little attention to the cost of credit. Generally, they believed interest rates were not and should not be a major consideration when choosing a lender. Instead, they told us that savvy financial managers build relationships with lenders that give them easy access to credit, so that they can access funds quickly, without hassles and repay over a sufficient amount of time.

Several respondents reported serious challenges managing credit through the exploding number of joint liability groups. The concept of a guarantor for some was unclear, whereas for others, while they understand the idea, it has not translated into any action involving monitoring of group members whose loans have been guaranteed.

A young motorcycle taxi driver expressed his fears over being in a joint liability group:

> *"Some. . . people who don't know how to read and write, sometimes they are tricked and you are told to act as a guarantor and you use your land as security and in the end it is like you sold your shamba [farm] and yet you don't know because you don't know how to read and write and then the document says that you sold the shamba and in your mind you think that you are just* guaranteeing them, so you end up losing your shamba."

A member of a joint liability group explains that being a guarantor doesn't mean you closely monitor the borrower:

> *"Loans are someone's secret. When you are someone's guarantor, you don't ask why they are taking a loan, you must go on their character, as far as you can tell."*

In summary, the channel through which a financial service is delivered may pose less risk to consumers than the nature and complexity of the product itself in terms of the analytical skills needed to assess its merits and make comparisons across providers. While consumers feel very safe using and seeking redress from M-PESA, there are indications of knowledge and consumer protection gaps when it comes to credit relationships.

RETHINKING FINANCIAL CAPABILITY OF THE POOR

The concept of financial capability developed and applied to middle income households in advanced economies cannot merely be downsized for low income households in developing ones. The cash flows of the poor are not just smaller, they are fundamentally different in nature, and that has a profound ripple effect on salient financial management decisions. The table below summarises the critical distinctions between these two paradigms.

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9 A survey of 1548 individuals on consumer protection in financial services in Kenya was conducted by Financial Sector Deepening Kenya in March 2010 and every person who had encountered a problem with M-PESA had it resolved, most within one day. In comparison, many of the problems respondents had with banks were never resolved. In an earlier survey of 3003 individuals, mainly M-PESA users, done in 2008 and again commissioned by Financial Sector Deepening Kenya, it was found that 1% of the sample had lost money saving with M-PESA, the same proportion that had lost money saving with banks. As a comparison, 5% of the sample had lost money saving with savings groups and 5% of the sample had lost savings by hiding it at home.

10 Overwhelmingly, the biggest problem reported with M-PESA was from sender error. The sender types a recipient's phone number incorrectly, inadvertently sending it to another person. Respondents reported that if the incorrect recipient withdraws the funds before Safaricom can stop the transaction, there is nothing Customer Care can do to help.

Financial characteristics of different income groups

High and middle income	Low income
Earning money and managing money are **separable** tasks. Financial management is more about *resource allocation*: distributing a regular cash inflow across immediate expenditure, intermediate savings, and more distant investment to maximize value available for life events and old age.	In the absence of reliable lifetime employment, earning and allocating money are **inseparable**. Individuals and families seek to maximize income flows, even those with salaries seeking additional business investments to boost income.
Cash flows are **orderly**.	Cash flows are **erratic** and unpredictable.
Financial decisions tend to be **large, analytical, and infrequent**. Maximising outcomes therefore requires specific knowledge and skill in understanding and interpreting sector vocabulary and the terms of financial products.	Financial decisions that affect family living standards are **small, daily** expenditure and savings choices, requiring **discipline** more than analytical skill.
Individuals **compartmentalise** financial decision making, setting aside time to review portfolios, seek advice.	Financial decisions are **relentless, unavoidable, and urgent**.
Consequences of financial decisions are felt in the **medium to long term**.	Consequences of financial decisions are often **immediate** and painful, particularly for those living on the margins of survival.
Individuals get themselves into financial trouble by reaching for an **asset** (for example, taking on an unaffordable mortgage) or **failing to save enough for the distant future.**	Individuals fall into financial trouble from **indulgence**, from succumbing to consumption temptations. Our respondents most frequently pointed to drugs, alcohol, and multiple partners.
Financial capability is concerned with **knowledge and analytical skills**; thus, building capability is associated with more traditional forms of **education**.	Financial capability is about **character** (particularly restraint) as much as skill, and as such, people believe that it is a function more of **natural ability and experience** than more analytical types of education.
Financial management is **more like designing and implementing a personal strategic plan.** Individuals need *specialised knowledge*, foresight, and proper use of financial instruments of varying maturities.	Financial management is like **managing your diet**, in which the long term vision is subordinate to daily decisions. *Commitment devices* are particularly powerful tools for reinforcing the *discipline* to make preferred daily choices.

POLICY IMPLICATIONS

We believe that this new conceptualisation of financial capability points to three potential policy implications:

1. **Because experiences and testing markets is so core to building financial capability as well as improving financial inclusion, one cannot rely on financial education alone to build consumer protection.** Education prior to the introduction of formal services may not be absorbed without use. But more importantly, consumers need to know where to go and how to get answers. If they get answers, even if they don't like them, they will stick with the product. So, well-designed, effective institutional level consumer care services are paramount to keeping consumers both protected and engaged.

2. **Accessible redress mechanisms and simple, transparent communications about costs and terms of new services can build trust and help retain clients even after a bad experience.** Consumers trust M-PESA in part because all service costs are clearly advertised, and can be monitored with immediate feedback delivered through text message notifications. Many of our respondents were willing to stick with banks, even when shocked by fees, once the fee structures were explained thoroughly. In contrast, though, when they feel they've been wronged or cheated, they are often quick to walk away. Increasing financial inclusion necessitates not just bringing the poor into formal financial services, but ensuring that they are not driven out by these kinds of disappointments.

3. **Commitment features in financial products are a core way to build inclusion into the formal financial market.** Commitment features, including even M-PESA's small withdrawal fee, help poor consumers impose on themselves discipline which is such a strong feature in their ability to manage their money effectively and avoid the temptations of immediate spending.

M-PESA services are offered at independent agent shops or as an add-on service for a large range of other types of businesses.

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METHODOLOGY

The study approach that resulted in this FSD Insights edition can be downloaded from our website at the following link: www.fsdkenya.org/insights/10-12-14_Financial_Capability_&_the_Poor_Methodology.pdf

About the Financial Education and Consumer Protection Partnership (FEPP)

The FEPP is a public-private sector partnership driving the development of a comprehensive national financial education strategy for Kenya. Together, the partnership aims to build a strategy that finds effective ways to improve the nation's knowledge and understanding of personal finances.

FEPP offers the prospect of strengthening the development of financial markets and enhancing the impact of expanded services on the livelihoods of Kenyans, especially among poorer groups. If this potential is to be realised then the long-term vision needs to be bold and the ambition from the outset should be the creation of a comprehensive, national programme. There are some encouraging initiatives already underway and a credible route to achieving major impact has been defined.

Work has been ongoing to understand practically what works and doesn't work in Kenya and to motivate the key stakeholders who can drive the longer-term programme. The objective for this project will therefore be to establish the foundations for a comprehensive and sustainable programme of financial education in Kenya. FEPP is supported and coordinated by the Financial Sector Deepening (FSD) Kenya, a multi-donor financial sector development programme.

A joint research initiative of FSD Kenya, Consultative Group to Assist the Poor(CGAP) and Bankable Frontier Associates (BFA).

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The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation.

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