Analyzing the Financial Capability of People in Wisconsin

In recent years, the term "financial capability" has started to replace "financial education" in discussions about how to improve individuals' financial management. The concept of financial capability was first developed in the United Kingdom and Canada and is now being applied worldwide, including in the United States.[1] Signs of this shift include the formation of the President's Advisory Council on Financial Capability in 2010—the previous Council focused on "Financial Literacy." Nevertheless, what does it mean to be "financially capable," how does financial capability differ from financial literacy, and are these terms simply buzzwords with short shelf lives? This brief describes the relationship between financial literacy and financial capability and presents data from the National Financial Capability Study.

From Financial Literacy to Financial Capability

Financial capability is a more expansive concept than financial literacy. Financial literacy is one component of financial capability, but financial capability includes additional considerations. Financial literacy typically refers to the knowledge and skills needed to make sound financial decisions. Financial capability includes financial literacy, but adds access to financial services, behavioral factors, social influences, and emotions.[2] In developing a model of financial capability, Sherraden (2010) defines financial capability as both the ability to act (i.e. internal capacities such as knowledge) and the opportunity to act (i.e. availability of products that are accessible, affordable and financially attractive, easy to use, and safe and reliable). Similarly, the President's Advisory Council defines financial capability as "the capacity, based on knowledge, skills, and access, to manage financial resources effectively."[3]

Making matters more complicated, financial literacy itself has been defined in a variety of ways—and oftentimes goes undefined even in academic studies. Furthermore "financial knowledge" and "financial literacy" are often used interchangeably (Huston, 2010).

Figure 1 displays another conceptualization of financial capability. Financial capability is comprised of four components: knowledge, influences, access, and action. The knowledge quadrant again corresponds to what is typically termed "financial literacy." The influences quadrant recognizes that knowledge and skills do not automatically translate into specific actions or outcomes. A variety of influences, including behavioral factors such as procrastination, affects how individuals apply their knowledge. The access quadrant is perhaps the most important difference between financial literacy and financial capability. The financial capability approach emphasizes the role that access to beneficial financial products and services plays in households' financial wellbeing. A lack of access might manifest as frequent

[1] Sherraden, M. S. (2010). *Financial capability: What is it, and how can it be created?* Center for Social Development Working Paper No.10-17. Washington University in St. Louis.
[2] Jump$tart Coalition. Frequently Asked Questions.

[3] President's Advisory Council on Financial Capability. Executive Order 13530. January 29, 2010.

use of often-costly non-bank borrowing services (Sherraden 2010). Finally, Figure 1 includes a separate quadrant for action, further emphasizing that behavior emerges from a complex interplay of factors. Knowledge and skills alone do not necessarily translate into behavior.

In terms of implications for policy and practice, the financial capability approach invites to expand upon existing financial education efforts. Financial capability is not a rejection of financial literacy, but instead a recognition that other considerations

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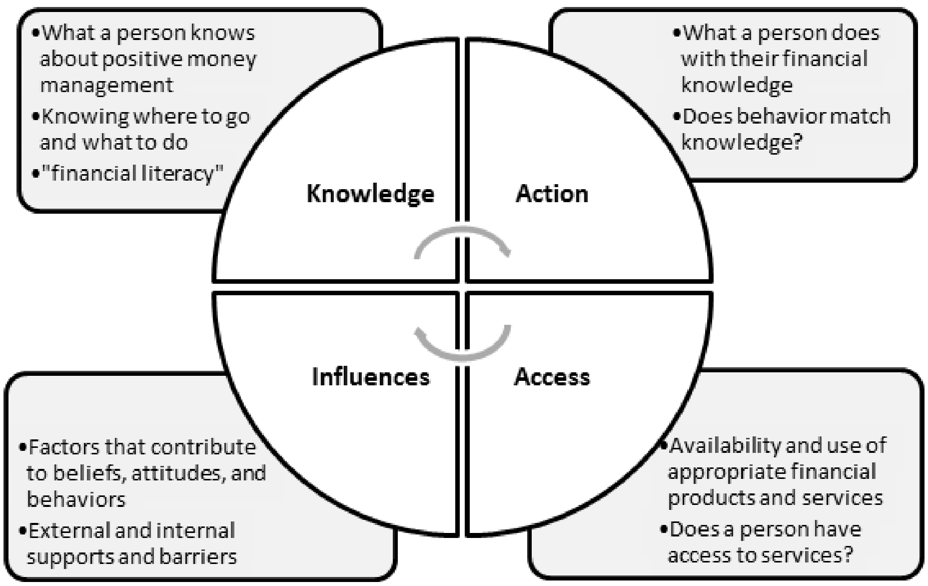
Figure 1: Financial Capability



Source: Peggy Olive, UW Cooperative Extension Family Living Program "The Role of Helping Professionals in Building Financial Capability"

Data for Wisconsin

The National Financial Capability Study (usfinancialcapability.org) is a large-scale study that measures Americans' financial capability in four areas: making ends meet, planning ahead, managing financial products, and financial literacy and decision-making (the full list of survey questions is available here). The Study was commissioned by the FINRA Investor Education Foundation and is the first of its kind in the United States. The Study consists of three surveys: a national telephone survey, a state-by-state online survey, and an online survey of military personnel and spouses. The surveys were first collected in 2009, with a second survey wave in 2012. The results of the 2012 survey are not yet publically available but should be posted on the Study's website within the next few months.

The tables below display data from the 2009 survey wave for Wisconsin, the United States as a whole, and the East North Central Census region (Wisconsin, Illinois, Michigan, Indiana, and Ohio). Differences between groups may or may not be statistically significant and all measures are all self-reported.

Table 1 displays survey findings on making ends meet and planning ahead. Similar percentages of respondents (≈40% each) reported that their spending was less than or about equal to their income over the past year. Seventeen percent of respondents reported spending more than their income, and a similar percentage (16%) reported that covering their expenses was "very" difficult in a typical month. Four-in-ten respondents reported no difficulty in covering their monthly bills, with 43% reporting some difficulty in covering expenses. Likely due in part to the sharp economic downturn that began in late 2007, 35% of respondents had experienced a large unexpected drop in income over the previous year. Among respondents with a checking account, about one-quarter (23%) reported occasionally overdrawing their account. Seventeen percent of respondents with mortgages had made at least one late mortgage payment in the previous two years, with 10% doing so more than once. Eight percent of respondents with a retirement account had taken a loan from the account within the past year, and 7% had taken a hardship withdrawal. In terms of planning, only 39% of respondents had emergency funds that could cover three months of expenses. Four-in-ten non-retirees had ever calculated their retirement savings needs, and 35% of parents with dependent children set aside money for overall children's college education. Across all of the measures, the differences between WI and national and regional data are minimal.

Table 1. Making Ends Meet and Planning Ahead

Measure	WI	Nation	Region
Making Ends Meet			
Spending over the past year			
less than income	41%	42%	42%
equal to income	38%	35%	36%
more than income	17%	20%	18%
Difficulty covering expenses and paying bills in typical month			
Very	16%	18%	19%
Somewhat	43%	43%	42%
Not at all	39%	36%	37%
Large unexpected drop in income in past year	35%	40%	41%
Overdraw checking account occasionally (has checking)	23%	26%	25%
Late mortgage payments in past 2 years (has mortgage)			
One	7%	8%	7%
More than one	10%	13%	13%
Taking from retirement account in past year (has retirement plan)			
Loan	8%	10%	11%
Hardship withdrawal	7%	8%	8%
Planning ahead			
Have emergency funds to cover 3 months expenses	39%	35%	34%
Ever tried to figure out retirement savings needs (non-retirees)	39%	37%	36%
Setting aside money for children's college education (have dependent children)	35%	31%	30%

Source: Summary of Selected Findings: Wisconsin, FINRA Investor Education Foundation.

Table 2 displays findings for managing financial products and financial literacy and decision making. The vast majority of Wisconsin respondents have checking or savings accounts (91% and 79%, respectively). Yet, one-in-in five respondents reported using at least one of non-bank borrowing methods (auto title loans, payday loans, refund anticipation loans, pawn loans, or rent-to-own outlets) in the past five years.

Turning to credit, the majority of respondents (58%) had two or more credit cards, 17% had a single credit card, and 22% did not have a credit card. Over one-half of respondents (55%) who had a credit card carried a balance and were charged interest over the past year. Thirty-five percent of credit card holders only paid the minimum balance over the past year, one-in-five had been charged a late fee, and smaller percentages (12% each) had been charged an over the limit fee or taken a cash advance. Just thirty-seven percent of credit card holders compared card offers when they opened their last card. About four-in-ten respondents had obtained their credit report in the past year. The same percentage had viewed their credit score over that period.

Finally, the survey measured financial knowledge through the following five questions:

1. Suppose you had $100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow? (more than, exactly, less than $102; don't know)
2. Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account? (more, same, less than today; don't know)
3. If interest rates rise, what will typically happen to bond prices? (rise, fall, stay the same; don't know)
4. A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage, but the total interest paid over the life of the loan will be less. (true, false; don't know)
5. Buying a single company's stock usually provides a safer return than a stock mutual fund. (true, false; don't know)

The mean number of correct responses was 3.14 for Wisconsin respondents. The average number of incorrect and "don't know" responses were 0.70 and 1.11, respectively.

Conclusion

Financial capability is different from financial literacy. The new FINRA survey offers opportunity to measure aspects of financial capability unique to Wisconsin and provokes a range of discussions about how best to boost the ability of people to manage their finances. Education is still clearly one important strategy, but the data also suggest a more comprehensive approach, including a well-being or wellness focus that does not judge the choices people makes, but helps them in the context of the services and products available to them.

Table 2. Managing Financial Products and Financial Literacy & Decision-Making

Measure	WI	Nation	Region
Managing Financial Products			
Has checking account	91%	91%	90%
Has savings account, money market, or CDs	79%	74%	74%
Non-bank borrowing methods used in the past 5 years			
Auto title loan	7%	6%	5%
Payday loan	9%	9%	9%
Advance on tax refund (RAL)	4%	6%	6%
Pawn shop	8%	12%	9%
Rent-to-own	3%	7%	5%
One or more non-bank borrowing method in past 5 years	19%	24%	21%
Credit cards			
No cards	22%	24%	25%
1 card	17%	15%	15%
2 or more cards	58%	58%	57%
Credit card use in past year | have credit card(s)			
Always paid in full	44%	41%	42%
Carried a balance and was charged interest	55%	56%	56%
Paid minimum only	35%	40%	39%
Charged a late fee	21%	26%	25%
Charged an over the limit fee	12%	15%	14%
Took cash advance	12%	13%	12%
Financial Literacy & Decision-Making			
5 financial knowledge measures (see text for the measures)			
Mean # correct out of 5	3.14	2.99	3.01
Mean # incorrect out of 5	0.70	0.73	0.72
Mean # "don't know" out of 5	1.11	1.21	1.20
Compared credit cards (has credit card)	37%	32%	32%
Compared auto loans (has auto loan)	47%	44%	41%
Obtained a copy of credit report in past year	39%	42%	41%
Obtained credit score in past year	40%	41%	40%

Source: Summary of Selected Findings: Wisconsin, FINRA Investor Education Foundation.

Additional Resources

1. National Financial Capability Study**.** Interactive website with state, regional, and nationwide findings across four areas: making ends meet, planning ahead, managing financial products, and financial literacy and decision-making. Results from the 2012 survey wave should be available on the website soon (the 2009 results are currently available).
2. Financial Capability Toolkit. Resource guides for schools, institutions of higher education, community leaders, and employers interested in creating financial capability initiatives. Each guide includes a list of key steps and further resources.
3. Papers & Reports
    a. Atkinson, A., McKay, S., Collard, S., & Kempson, E. (2007). Levels of Financial Capability in the UK. Public Money & Management, *27*(1), 29-36. The concept of "financial capability" was pioneered in the UK. This report describes financial capability and presents survey findings.
    b. Johnson, E., & Sherraden, M. S. (2007). From Financial Literacy to Financial Capability among Youth. Journal of Sociology & Social Welfare, *34*(3), 119-146. Discusses the importance of expanding financial capability among American youth, with an emphasis on improving access to financial policies and services.
    c. Lusardi, A. (2011). *Americans' Financial Capability*. National Bureau of Economic Research Working Paper Series, No. 17103. Report on Americans' financial capability using data from the National Financial Capability Study.
    d. Sherraden, M. S. (2010). *Financial capability: What is it, and how can it be created?* Center for Social Development Working Paper No.10-17. Washington University in St. Louis. A comprehensive overview of financial capability and how it differs from financial literacy.
4. "Financial Literacy or Financial Capability?" Blog post by Annamaria Lusardi, a leading scholar on financial literacy.
5. Center for Financial Security's 2012 *Exploring New Frontiers in Financial Capability Research for Vulnerable Populations* Workshop. In June 2012, CFS hosted a research workshop in Madison that brought together leading scholars from across the country. Topics included *Assets, Debt and Well-Being*; Behaviorally-Informed Financial Products & Services; and *Financial Advice and Counseling*. The workshop's website includes papers and presentations.
6. The President's Advisory Council on Financial Capability. The Council was formed by Executive Order in 2010 and was tasked with identifying ways to increase Americans' financial capability through financial education and financial access. The Council ended on January 29, 2013, but its website still contains many useful resources about financial capability (be sure to check the previous meetings section).

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The University of Wisconsin-Extension (UWEX) Cooperative Extension's mission extends the knowledge and resources of the University of Wisconsin to people where they live and work. Issue Briefs are an ongoing series of the Family Financial Education Team. This brief was drafted by J. Michael Collins, Assistant Professor in Consumer Finance and Extension State Specialist, Center for Financial Security