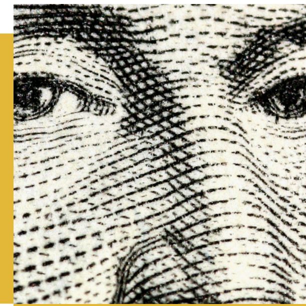
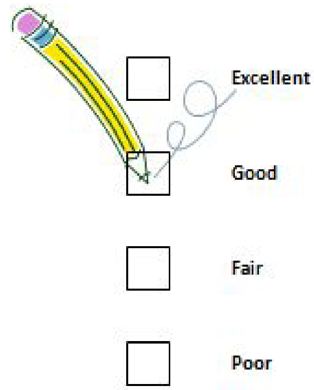
issue briefs

Family Financial Education

2015-2



THE FINANCIAL CAPABILITY SCALE



Background

In 2011, the Center for Financial Security at the University of Wisconsin launched an outcome measures project funded by the Annie E Casey Foundation to test a set of measures for the financial capability field to use in a field setting. The goal was to refine a small set of standardized measures that could be used on a daily basis, as opposed to a survey instrument used for ad hoc research studies.

The purpose of such a measure includes:

1. Diagnosis: for the purpose of matching clients to the most appropriate services

2. Collaboration: to document common characteristics and coordinate strategies across programs

3. Assessment: to assess how clients progress through programs

Development of the Financial Capability Scale (FCS)

A range of questions were tested by the Center for Financial Security with nonprofit organizations providing financial coaching, counseling and education with clients. In many cases data was also collected from credit reports, bank accounts or employment. This allowed sets of questions to be compared to these external sources of information as a test of *validity*—that is the extent to which a set of questions accurately reflect current financial status. For example, the FCS appears to be correlated with credit score and delinquency rates, such that the FCS is a relatively valid proxy for credit status.

The FCS was also tested over time, where some clients answered the same questions at different periods. This allowed for a test of *reliability*—that is the extent to which people are consistent in their answers to questions and the scale does not contain a high level of random responses or "noise" that makes the scale volatile and hard to use. The FCS was also tested for internal reliability, which is a widely used measure in scale development to show that a set of questions share a common statistical construct, but that each measure provides some

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unique value to the overall measure. This helps focus the FCS on the smallest number of questions to reasonably measure financial capability.

Understanding the FCS

The FCS is based on a series of 6 subjective self-reported responses. These include a mix of reported behaviors, as well as feelings or perceptions. The FCS does not use objective values such as savings or debt levels. This is because these types of measures are difficult to collect with any degree of reliability or validity. These measures also may not offer insights into financial capability; for example, a client might borrow more and save less in pursuit of a particular financial goal.

Table 1 shows the items in the FCS which correlate to basic constructs that are a reasonable proxy for financial capability. The construct have, at least preliminarily, been shown to be correlated with credit score and other positive financial outcomes.

Budgeting: The budgeting or financial planning question (survey question 1) is a behaviorally-focused measure, including identifying if the client has a *future orientation* and is planning ahead, as opposed to having no plan. **Financial Goals** and **Goal Confidence:** Asking about financial goals provides insights about if a client has intentions to engage in new and different financial behaviors in the *future*. This question in the FCS also asks about the respondent's confidence in goal attainment. People are more likely to pursue and achieve a goal if they have confidence in their self-assessed ability to pursue the goal. (Note that this measure may decline in the short run for clients after taking part in a program, as they now better understand the challenges they face in their financial lives.) **Auto Deposit/Save:** The rationale for a question about using an automated deposit for savings is based on the fact that most people will fail to save (or pay bills) if they have to affirmatively act to transfer funds. Automating deposits removes discretion and signals a self-awareness that these kinds of constraints actually help promote better financial habits. **Emergency Fund:** The response to setting aside funds for an emergency signals whether or not they are anticipating contingencies; having access to liquidity can help *avoid a hardship* such as missing a housing payment or food insecurity. **Spending < Income:** A positive response to a question about spending more (or less) than income can signal planning ahead, as well as *paying attention* to spending—being mindful about financial behavior. **Late Fee:** Finally, paying a late fee on a bill, or more accurately avoiding late fees, is a another sign of *planning and paying attention*. As stated previously, these constructs form the FCS, and are a reasonable proxy for financial capability.

Table 1: Constructs in the Financial Capability Scale

Concept	Constructs Measured
Budgeting	Budgeting and planning are signals of having a *future orientation* about money
Financial Goals & Goal Confidence	*Subjective capability* to engage in goal-focused financial behavior; signal of *future orientation*
Auto Deposit/Save	Recognizing *self-control failures* and removing discretion is key to behavior change
Emergency Fund	Anticipating contingencies signals *capacity to avoid economic hardships*
Spending < Income	Spending less than income is signal of *paying attention* to spending behavior
Late fee (none)	Signal of *planning and paying attention*; direct component of credit score

Questions in the FCS

FCS question wording has evolved over time with each use. In some cases survey forms or programs have adapted questions slightly. There does not appear to be a significant impact on the statistical properties of the FCS from these rewordings. The basic set of questions is outlined on the next page, including the scoring for each response. Note that question #2 has a 0, 1, 2 response, meaning the scale is out of 8 points total. Note also that the last question is reverse coded such that no late fee is considered a positive response.

1. Do you currently have a personal budget, spending plan, or financial plan? (Yes = 1, No = 0)

2. How confident are you in your ability to achieve a financial goal you set for yourself today? (Not at all = 0, Somewhat = 1, Very = 2)

3. If you had an unexpected expense or someone in your family lost a job, got sick or had another emergency, how confident are you that your family could come up with money to make ends meet within a month? (Not at all = 0, Somewhat = 1, Very = 2)

4. Do you currently have an automatic deposit or electronic transfer set up to put money away for a future use (such as savings)? (Yes = 1, No = 0)

5. Over the past month, would you say your family's spending on living expenses was less than its total income? (Yes = 1, No = 0)

6. In the last 2 months, have you paid a late fee on a loan or bill? (Yes = 0, No = 1)

Variations on the FCS include omitting question #4, especially for populations that are unlikely to have a formal banking relationship. Another variation is adding another confidence category ("extremely" confident) in question #2 and then scoring each response in half point (0.5) increments. Other versions of the FCS have substituted the language used for the time period. In the version shown here, the wording for time period is "currently," "today," "over the past month" and "in the last 2 months." In other versions the questions indicated different time periods, such as "over the past 3 months" for Questions 3, 5 and 6. These variations reduce the ability of the FCS to be combined across programs, but may be acceptable as long as they are consistent within programs.

Note on Statistical Properties

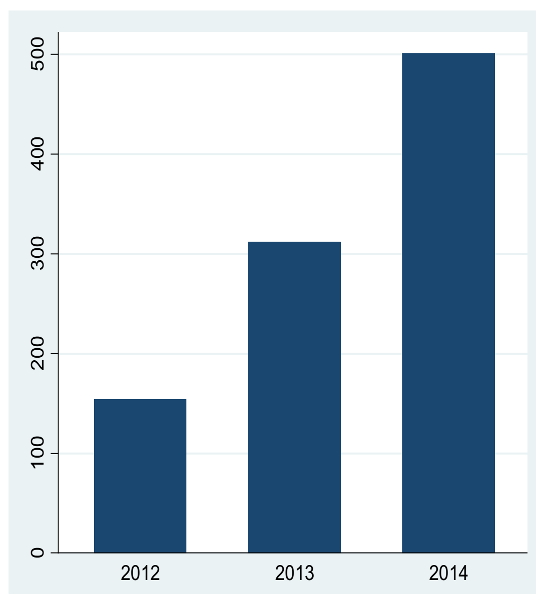
The FCS has a relatively weak internal reliability measure (often called Cronbach's alpha) of about 0.60. This means the FCS remains a fairly noisy measure and is not a strong signal of unidimensional construct. However, there is an inherent tradeoff with a field-based measure, where clients and practitioners need a short and relevant set of questions. A longer set of questions might produce a higher alpha score, but would weaken the ability for people to use the FCS in the field. Moreover, even with weak internal reliability, the FCS is predictive of credit score.

The average credit score for a someone with an FCS of under 3 is 580; the average score for someone with an FCS of over 6 is 700. The FCS remains a good proxy for contemporaneous credit status. To the extent credit score is one proxy for financial behaviors and capabilities, the FCS offers an easy mechanism to measure current financial status

Using the FCS

The FCS can be completed on paper or online in less than 4 minutes in most cases. Ideally, the FCS is easy enough to administer that clients can complete the scale at the start of any program or service, and then complete the FCS again at a later date. This might be at future appointments or sessions, or via a follow-up email or mailed survey. Figure 1 shows the use of the FCS as part of a standardized "core" survey used by UW-Extension Financial Educators in Wisconsin as of the end of 2014. There has been steady growth over time, with around 500 completed surveys in 2014.

Figure 1: Number of Core Surveys Completed in UW-Extension Cooperative Extension Family Living Programs



The core survey is sent to participants approximately 3 months after the baseline survey is collected. Not all clients provide email or mail addresses for follow-up, and without an intensive design many people will not notice or respond to an email requesting follow-up. However, about 15-20% of people who take a baseline FCS complete a follow-up survey, a result consistent with other survey methods. Currently FCS responses are not linked at the individual level to protect the identity of human subjects. However, the average baseline and follow-up scores are encouraging. Figure 2 shows FCS responses at each point in time. On average baseline scores are around 3.5 (out of 8) and follow-up FCS is over 4.0. Follow-up scores appear to be higher than baseline. This is consistent with people expressing higher degrees of financial capability after taking part in programs.

Figure 2: Average FCS at Baseline and Follow Up

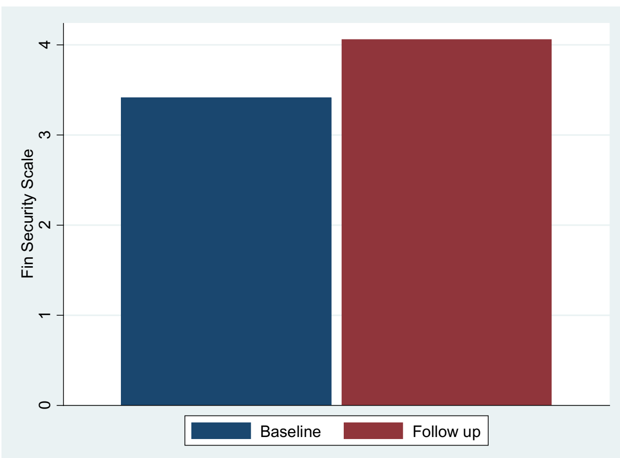
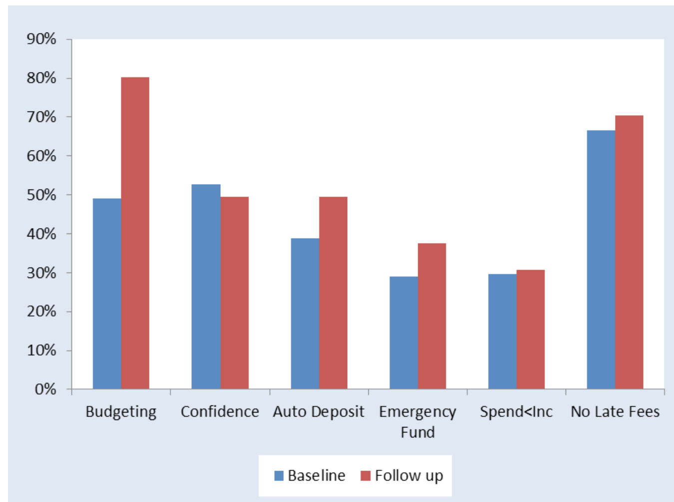


Figure 3 shows individual questions related to the FCS. At baseline only about half of people say they have a budget or financial plan, and a similar portion are confident they can achieve their financial goals. Less than 40% use automatic savings mechanisms and one-third have an emergency fund. A similar share spends less than their income, and about two-thirds avoid late fees.

With the exception of confidence in achieving goals, follow-up measures are higher on average than baseline. In some areas, notably budgeting, using automatic deposit and emergency funds, the follow-up measures are significantly greater. Spending less than income and avoiding late fees—behaviors that might be harder to control—show smaller differences.

Figure 3: FCS Components



Conclusions

The FCS is an easy to use field-ready tool to measure the financial capability status of clients in financial programs. It is sensitive to changes over time, and related to external measures such as credit score. Programs can use the FCS as a way to diagnose client readiness for programs, aggregate client characteristics across programs and to conduct program assessments and evaluations. It is inexpensive to administer and fills a gap between objective knowledge measures and more intensive administrative data collection. It is a complement to other data collection strategies programs use or report to funders, hopefully providing insights that result in improved program delivery.

University of Wisconsin-Extension

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, Associate Professor in Consumer Finance and Extension State Specialist, Center for Financial Security