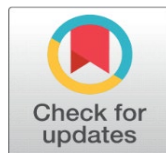
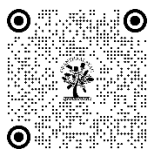


DIMENSIONS OF MEASURING FINANCIAL CAPABILITY: A REVIEW

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ABSTRACT

Financial Capability includes both 'Financial Literacy' and 'Financial Inclusion'. Financial Literacy refers to an individual's capacity to make decisions in their optimal financial interest, while Financial Inclusion refers to the opportunity of individuals to utilize this capacity to act in their best financial interest. Numerous research on financial capabilities has been done from a variety of angles. The present review study is an attempt to identify the dimensions of measuring financial capability adopted in the existing studies. The study found two distinct sets of dimensions: the Normative/ Cognitive Approach and the Positive/ Agnostic Approach. The present study attempts to introduce a new framework for measuring financial capability adopting the dimensions identified from the literature.

Keywords: Financial Capability, Dimensions, Approaches, Review

1. INTRODUCTION

Financial capability has been defined differently by different authors. According to Sherraden (2013), Individuals with financial capability possess both the ability and the opportunity to make decisions that enhance their financial well-being in their best interests. Financial capacity was defined by Ramana and Muduli (2018) in an RBI working paper as having sufficient financial knowledge to manage and use financial products for present and future requirements. According to Perotti & Zottel (2013), financial capability is the internal ability to make decisions that are in one's best financial interest in light of the socioeconomic context. From the definition provided by different authors, financial capability can be understood as the ability to make financial decisions in order to achieve financial well-being by combining an individual's internal ability with external opportunities and possessing financial capacity gives a person the ability to manage finances in their best interests.

The importance of becoming financially capable is increasing day by day as the frequent introduction of new financial products and services, changing government policy towards retirement saving, and increasing household debt are the major reasons. The rise in digital financial products and services is easing accessibility at the same time also

increasing the cases of financial fraud. From January 2020 to June 2023, over 75% of cybercrimes in India were financial scams, with online banking and UPI accounting for close to 50% of incidents (Hindustan Times, 2023). Another issue of worry in India is the increase of credit card defaults. The Minister of State for Finance Bhagwat Karad mentioned in his statement that the gross non-performing asset (GNPA) in Mar 2022 in credit cards was Rs. 3,122 Crore which increased to Rs. 4,072 Crore in Mar, 2023 and credit card outstanding is also increased from Rs. 1.64 lakh Crore in Mar, 2022 to Rs. 2.10 lakh Crore in Mar, 2023.

The above-mentioned facts highlight the need for the study of financial capability and the present study is an attempt to identify the dimensions of measuring financial capability used in previous studies. It is expected that the findings of the study will contribute to the formulation of the strategy and policies to improve the financial capability of the country.

2. STUDIES ON FINANCIAL CAPABILITY

The terms 'Financial Literacy' and 'Financial Capability' are commonly used interchangeably. However, insights from studies by Johnson and Sherraden (2007), Collins (2013), and the World Bank (2013) reveal that "Financial Literacy" refers to the internal capacity for making informed financial decisions, while "Financial Capability" is a broader concept that encompasses both financial literacy (internal capacity) and financial inclusion (external opportunity). In essence, achieving financial capability involves not only possessing the ability to make informed financial decisions but also having access to financial products and services or the opportunity to apply that ability.

There is no universal definition of financial capability. The diversity in the definition of financial capability leads to the adoption of different dimensions in different studies of measuring financial capability. According to the World Bank Report, 2013, the dimensions of measuring financial capability are 'Financial Knowledge and Awareness', 'Financial Skill', 'Financial Attitude' and 'Financial Behaviour'. On the other hand, A review study conducted by Zakaria and Sabri, 2013 identified four main dimensions of measuring financial capability: 'Managing Money', 'Staying Informed', 'Choosing Products', and 'planning ahead'.

According to the study conducted by Holzmann et al., 2013, there are two approaches to measuring financial capability, under which the major dimensions of financial capability can be classified. These are the Normative/ Cognitive Approach: Dimensions followed in this approach are- "Financial Knowledge", "Financial Skill", "Financial Attitude", "Financial Behaviour" and "Financial Inclusion". The Positive/ Agnostic Approach: Dimensions followed in this approach are- "Managing Money", "Planning Ahead", "Making Choices", and "Getting Help".

The study conducted by Johan, 2018 was an attempt to combine the different sets of dimensions identified in the study of Holzmann et al., 2013. However, one of the major dimensions of financial capability like financial inclusion was not considered in that study. The existence of diverse dimensions of financial capability in the literature raises the need to develop a new framework for measuring financial capability considering all the major dimensions.

3. METHODS

To find out the previous studies conducted on financial capability the "Google Scholar" scholarly web search engine was used. The terms "financial capability"; "dimensions of financial capability"; and "measuring financial capability" were used to search the existing studies conducted on financial capability. The studies with titles mentioning financial capability and clearly specifying the dimensions of financial capability were included in the present studies. A total of 35 studies were included in the present study. Chart no.1 shows the selection process of previous studies.

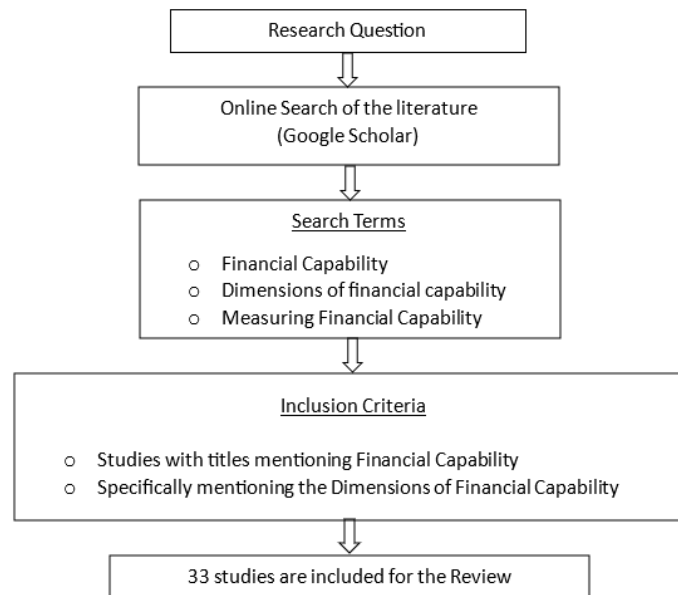


Chart No. 1 The Procedure of Selecting Articles/ Research Papers

4. RESULTS AND DISCUSSION

It can be clearly observed that there are two distinct sets of dimensions for assessing financial capability. Furthermore, it is observed that most studies exclusively use one set of dimensions, following dimensions from one set and excluding dimensions from another set. Out of 35 studies, only 2 studies are observed combining both the 2 sets of dimensions. World Bank report titled “Financial Capability in low- and middle-income Countries: Measurement and Evaluation, 2013”, defined these two sets of dimensions:

a) The Normative/ Cognitive Approach: Dimensions followed in this approach are- “Financial Knowledge”, “Financial Skill”, “Financial Attitude”, “Financial Behaviour” and “Financial Inclusion”

b) The Positive/ Agnostic Approach: Dimensions followed in this approach are- “Managing Money”, “Planning Ahead”, “Making Choices”, and “Getting Help”.

The World Bank Report, 2013 states that the Positive/ Agnostic approach was initiated by the United Kingdom’s Financial Services Authority. It is observed that researchers later on classified the “Managing Money” into two sub-domains: “Making Ends Meet”, and “Keeping Track of Money”.

Table no. 1 shows the names of the authors, titles of the articles/ research papers/ previous studies on financial capability, and dimensions of measuring financial capability adopted in their study.

Table No. 1 Identification of Dimensions of Measuring Financial Capability

| Author/s (Year) | Title of the study | Dimensions of measuring financial capability |
|----------------------|---|--|
| Perotti et al., 2013 | Making Sense of Financial Capability Surveys around the World: A Review of Existing Financial Capability and Literacy Measurement Instruments | Financial Knowledge Financial Skill Financial Attitude Financial Behaviour |
| The World Bank, 2018 | Investigating the Financial Capabilities of SMEs: Lessons from a 24-Country Survey | Financial Knowledge Financial Skill Financial Attitude Financial Behaviour |
| Xiao et al., 2022 | Financial Capability: A Systematic Conceptual Review, Extension, and Synthesis | Financial Knowledge Financial Behaviour Financial Outcome Financial Opportunity |

Dimensions of Measuring Financial Capability: A Review

| | | |
|----------------------------|--|---|
| Vyvyan et al., 2014 | Factors that Influence Financial Capability and Effectiveness: Exploring Financial Councillors' Perspectives | Attitude Perceived Behaviour Skill and Knowledge |
| Sherraden, 2010 | Financial Capability: What is It, and How Can It Be Created? | Financial Knowledge and Skill Financial Inclusion |
| Goff, 2019 | Literacy and Financial Capability: An Evidence Review | Skill Behaviour Mindset |
| Kempson et al., 2006 | Measuring Financial Capability: An Exploratory Study | Managing Money Planning Ahead Making Choices Getting Help |
| Atkinson et al., 2007 | Levels of Financial Capability in the UK | Managing Money Planning Ahead Choosing Products Staying Informed |
| Atkinson, 2011 | Measuring financial capability using a short survey instrument: Instruction Manual | Making ends meet Keeping Track Planning Ahead Choosing Products Staying Informed |
| McQuaid and Egdel, 2010 | Financial Capability – Evidence Review | Making ends meet Keeping track of money Planning ahead Staying Informed Choosing financial products |
| O'Donnell and Keeney | Financial Capability in Ireland and a Comparison with the UK | Managing Money Planning Ahead Choosing Products Staying Informed |
| McKay, 2011 | Understanding Financial Capability in Canada: Analysis of the Canadian Financial Capability Survey | Making Ends meet Keeping Track Planning Ahead Choosing Products Staying Informed |
| Robson and Splinter, 2015 | A new (and better) way to measure individual financial capability | Making Ends meet Keeping Track of Money Planning Ahead Choosing Products Staying Informed |
| Mokhtar et al., 2020 | Financial Capability and Difference in Age and Ethnicity | Making Ends meet Planning Ahead Choosing Products Staying Informed |
| Cera et al., 2021 | Improving financial capability: the mediating role of financial behaviour | Financial Attitude Financial Knowledge Financial Behaviour Financial Inclusion |
| Sabri et al., 2020 | Effects of Gender and Income on Malaysian Financial Capability | Managing money Planning ahead Making Choices Staying Informed |
| Zakaria and Sabri, 2013 | Review of Financial Capability Studies | Managing Money Planning Ahead Choosing Products Staying Informed |
| O'Donnell and Keeney, 2009 | Financial Capability: New Evidence for Ireland | Managing Money Planning Ahead Choosing Products Staying Informed |
| O'Donnell, 2009 | Consumer Financial Capability: A Comparison of the UK and Ireland | Managing Money Planning Ahead Choosing Products |

| | | |
|---------------------------|--|--|
| Lemu, 2020 | Financial Capability in Ethiopia: A Case Study of Addis Ababa City | Staying Informed Financial Knowledge Financial Attitude Financial Behaviour |
| Reddy et al., 2013 | Financial Capability in Mexico: Result from a national survey on financial behaviours, attitudes and knowledge | Financial Knowledge Financial Attitude Financial Behaviour Financial Inclusion |
| Storchi and Johnson, 2016 | Financial Capability for Wellbeing: An alternative perspective from the capability approach | Financial Knowledge Financial Skill Financial Attitude Financial Behaviour Financial Inclusion |
| Brown, 2020 | Economic Dignity and Financial Capabilities | Internal Context (Financial Knowledge, Skill, and Behaviour) External Context (System and Structure) |
| Cera et al., 2019 | Determinants of Financial Capability: Evidence from a Transition Country | Financial Attitude Financial Knowledge Financial Behaviour |
| Zottek et al., 2016 | Enhancing Financial Capability and Inclusion in Senegal | Financial Knowledge Financial Attitude Financial Skill Financial Behaviour Financial Inclusion |
| Reddy et al., 2013 | Financial Capability in Colombia: result from a national survey on financial behaviours, attitudes, and knowledge | Money Management Planning Ahead Choosing Financial Products |
| Zaimah et al., 2022 | The Financial Capability of the Millennial Generation During the Pandemic of Covid-19 | Financial Knowledge Financial Behaviour Motivation Opportunity |
| Atkinson, 2007 | Financial Capability amongst Adults with literacy and Numeracy needs | Making Ends Meet Keeping Track Planning Ahead Choosing Products Staying Informed |
| Bharghava et al., 2022 | Moderating Role of Personality in Relationship to Financial Attitude, Financial Behaviour, Financial Knowledge, and Financial Capability | Financial Behaviour Financial Knowledge & Skill Financial Attitude |
| Johan, 2018 | Financial Capability Among University Students in Indonesia | Financial Knowledge Financial Skill Financial Attitude Financial Behaviour (Managing Money, Planning Ahead, Choosing Products, and Staying Informed) |
| Hebert and Gyarmati, 2014 | Financial Capability and Essential Skills: An Exploratory Analysis | Making End Meet Keeping Track Planning Ahead |
| Nomlala and Sibanda, 2020 | Financial Capability of Accounting Students in South African Universities | Financial Knowledge Numeracy Skill Financial Attitude Financial Behaviour |
| Holzmann et al., 2013 | Financial Capability in Low- and Middle-Income Countries: Measurement and Evaluation | Normative/ cognitive approach: Knowledge skill, attitude, behaviour Positive/ Agnostic approach: Managing money, planning ahead, making choices, getting help |
| Ramana & Muduli, 2019 | Measuring Financial Capability of Street Vendors | Making Ends Meet Planning Ahead Managing Financial Products |

| | | |
|----------------|--|---|
| Parvathy, 2022 | Financial capability and financial well-being of women in community-based organizations: mediating role of decision-making ability | Financial Knowledge Financial Skill Financial Attitude Financial Behaviour |
|----------------|--|---|

Source Existing studies on financial capability retrieved from the Google Scholar search engine

Table no. 1 shows the names of the authors, titles of the articles/ research papers/ previous studies on financial capability, and dimensions of measuring financial capability adopted in their study.

Table No. 2 Frequency of the Dimensions of Financial Capability

| Approaches | Dimensions | Frequency |
|--|---|-----------|
| The Normative/ Cognitive Approach (17) | Financial Knowledge and Awareness | 18 |
| | Financial Skill | 13 |
| | Financial Attitude | 16 |
| | Financial Behaviour | 17 |
| | Financial Inclusion | 8 |
| The Positive/ Agnostic Approach (16) | Managing Money | 10 |
| | Making Ends Meet | 8 |
| | Keeping Track of Finances | 6 |
| | Planning Ahead | 18 |
| | Choosing Financial Products/ Making Choices | 17 |
| | Staying Informed | 13 |
| | Getting Help | 2 |
| Note: 2 studies were observed adopting dimensions from both approaches | | |

Source: Created by the authors from existing literature retrieved from Google Scholar

Table no.2 indicates the frequency of the dimensions of financial capability considered in the studies. It is found that out of 35 studies, 17 studies adopted dimensions from the Normative/ Cognitive Approach; 16 studies adopted dimensions from the Positive/ Agnostic Approach and in the remaining 2 studies dimensions from both approaches were adopted. The “Financial Inclusion”, and “Getting Help” dimensions were not included in the classification provided by World Bank Report, 2013. However, it is observed that “financial inclusion” was used in the studies while following the Cognitive Approach; and “Staying Informed” was used while following the Positive Approach.

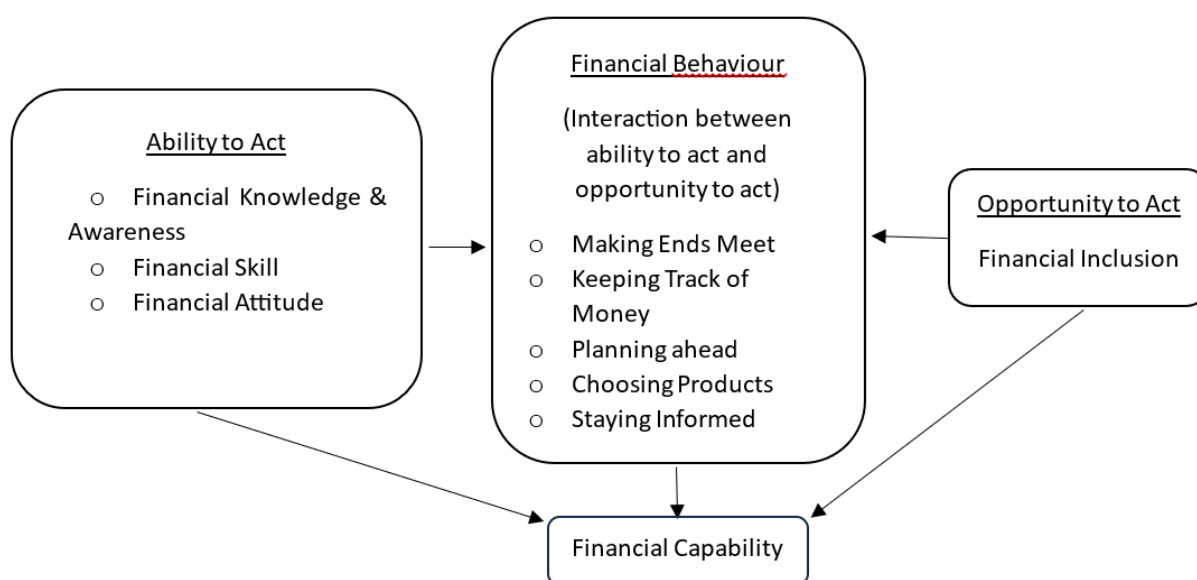


Chart No. 2 Dimensions of Financial Capability

Source: Developed from the literature

Chart no.2 presents the dimensions of financial capability developed from the literature. In the thesis titled “Financial Capability among University Students in Indonesia” by Johan, 2017, all the dimensions from the Positive/ Agnostic Approach were considered as a sub domain of “Financial Behaviour” which is one of the dimensions of the Normative/ Cognitive Approach. However, the “Financial Inclusion” dimension was not included in the study conducted by Johan, 2013.

5. CONCLUSION

In the present study, it is observed that the dimension used in a study is highly influenced by the definition framed or developed in the study. The existence of diverse definitions is the reason for adopting diverse dimensions in the existing financial capability studies. The study concludes that the major dimensions of financial capability can be classified into two sets as recognized in the study conducted by Holzmann et al., 2013. Further, the study also attempted to introduce a new framework for measuring financial capability considering all the major dimensions existing in the literature. However, the model of the framework is to be tested by conducting further study with primary data. It is believed that the findings of the present study will play a pivotal role in the conducting of future studies on measuring financial capability which will further contribute significantly to the formulation of strategies and policies aimed at enhancing the overall level of financial capability.

CONFLICT OF INTERESTS

None.

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