Financial competence as a tool for poverty reduction: Financial literacy and rural banking in the Pacific

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Financial competence, the understanding of, attitude to and management of, money is a potentially powerful tool in the fight against poverty. A range of financial literacy and financial inclusion programmes targeted at the disadvantaged have been developed and implemented in several developed economies. However, to date few programmes to increase the financial competence of the poor have been implemented in developing economies. This paper outlines the financial competence construct and the role financial competence can play in poverty alleviation. It examines a successful multi-jurisdictional, financial literacy and financial inclusion, collaboration between the United Nations Development Programme (UNDP) and ANZ Bank to enhance the financial competence of rural communities in the Pacific, and discuss the potential for replication in other contexts, and the implications for development actors, commercial organisations and regulators.

Financial competence and poverty

Sen (1999) has conceptualised poverty as the absence of capability, often evidenced by an economically driven absence of choice. Sen cites the example (1999:75) of an affluent person who fasts and may have the same functioning achievement (in terms of eating) as a destitute person who is forced to starve. The affluent person, however, has choice whereas the destitute person has no choice.

Nussbaum (2006:48) has argued that, by focusing on those things people can do and be, we come closer to understanding the barriers societies erect against the poor. The alleviation of poverty requires a focus beyond the 'income poverty paradigm' (Bourguignon 2006:76). Within this context, alienation from the money economy is the denial of an essential capability and a denial of choice. An absence of financial capability, whether driven by a lack of knowledge or skill, or the denial of access to the formal financial system, is the denial of the freedom to participate in the money economy.

Poverty is, however, not simply a lack of money. The alleviation of poverty cannot be achieved by merely increasing the household's ability to purchase food, access health and obtain shelter (although these factors are, of course, essential). The sustainable alleviation of poverty requires financial competence at both the individual and household level.

In a subsistence economy with high levels of informal exchange the inability to participate in the formal money economy may not, of itself, be a significant impediment to accessing basic nutrition and shelter requirements. However, in a globalising economy requiring participation in the money economy in order to access basic commodities, health, education and shelter, access to money, the ability to manage money and the opportunity to participate in the formal financial system become basic freedoms.

In this paper I propose that control over money, both the ability as well as the opportunity to exercise control over money, be considered an essential human capability. The management of money within the household is as important as the quantum of money the household receives. A core focus of development, therefore, must be to ensure individuals have adequate access to the instruments of the money economy and the required skills to manage participation in the money economy.

Poverty in the Pacific

The money economy is increasingly impacting Pacific communities. To date little has been done to ensure households and communities faced with the challenge of monetisation have the tools to be able to manage and control their interaction with the money economy.

Abbott and Pollard (2004:3), developing a definition of poverty relevant to the Pacific, define poverty as an inadequate level of sustainable human development manifested by:

- a lack of access to basic services such as primary health care, education and potable water;
- a lack of opportunities to participate fully in the socio-economic life of the community; and
- lack of adequate resources (including cash) to meet the basic needs of the household or the customary obligations to the extended family, village community, and/or church.

There appears to be a nexus between monetisation and poverty. Abbott and Pollard found evidence that an increasing number of Pacific Islanders are disadvantaged, and consider themselves to be disadvantaged. People in the Pacific are concerned that monetisation is placing an increasing burden...
on cash resources, causing in turn an increased requirement for cash income. The view of Pacific countries as places of 'subsistence affluence' is no longer correct.

Importantly, poverty is described by households in monetary or monetary related terms: the requirement for income, the requirement for a reasonable standard of basic services and the requirement for skills to meet opportunities and challenges. A quarter of households in the Pacific now have income/expenditures below the national poverty line (ibid:29).

**Inclusive financial sectors**

Access to a well-functioning financial system can economically and socially empower people (United Nations 2006). The development of an appropriate financial services environment specifically for the unbanked poor can play an important role in enhancing positive participation in the money economy, enabling the poor to access the formal payments system (both domestic and international), secure savings and well regulated and affordable credit. The development of inclusive financial sectors is therefore a potentially powerful tool in the fight against poverty.

**Financial exclusion**

Financial exclusion is a situation in which a person does not have access to, or elects not to access, financial products or services which would enable them to make informed decisions or organise their money effectively. The consequences of financial exclusion are significant. Lack of access to transaction banking facilities restricts access to the formal payments system. This imposes increased transaction costs and reduces ability to access a range of common transaction and payment services. Financial exclusion restricts access to regulated credit and forces individuals to utilise higher cost (and potentially predatory) sources of credit. Financial exclusion also limits opportunities for secure savings — both short/medium-term and longer-term savings.

Levels of banking exclusion vary across the developed countries. Kempson et al. (2004) found financial exclusion levels varying between one per cent and 17 per cent of the adult population. This headline figure is, however, deceptive. Those who are excluded from the formal financial system are typically people who live on low incomes or live in disadvantaged areas (ANZ 2004; Kempson et al. 2004; Kempson et al. 2000). For example, in the UK eight per cent of the total population are estimated to be without any form of bank account. However, this rises to 65 per cent among households in the bottom three income deciles (Clark, Foster and Reynolds 2005). At a broader level, Kempson et al. (2000) noted a fifth of people in the UK are on the margins of financial services and usually have little more than a bank account, and at least a quarter have no savings, home contents insurance or private pension (long term savings).

Research in developing countries is limited. However, it appears financial services are typically available to a minority of the population (United Nations 2006:1). Given the higher proportion of the population in developing countries living on low incomes and in disadvantaged areas, it is probable the extent of financial exclusion is higher than the levels evident in developed countries. Research in Fiji (Sharma and Reddy 2002) suggests two thirds of rural dwellers may not have access to reliable banking services. The level of financial exclusion experienced by urban dwellers is not known.

**Financial literacy**

Financial literacy encompasses the knowledge and skills required by individuals to function effectively in the money economy and make informed judgements in respect to their own and their family's financial circumstances. There is evidence of a correlation between financial literacy and positive financial behaviour, although the direction of causality is unclear (Hilgert, Hogarth and Beverly 2003).

Financial illiteracy can lead to self-exclusion from the formal financial system. Those who are financially illiterate are more likely to be intimidated by the complexity of the financial system. Financial illiteracy can also result in people making inappropriate decisions due to lack of knowledge or understanding. It is, for instance, common for predatory lenders to prey on those with limited financial knowledge and understanding.

As the financial system becomes increasingly complex, the requirement for financial literacy increases. The array of financial elements with which individuals must be competent also increases. The level of required literacy aligns with the level of an individual's participation in the financial system. Financial literacy is therefore both dynamic and situational.

A significant number of financial literacy programmes have been launched in recent years in developed countries, in particular the UK, USA and Australia (see, for example, Vitt et al. 2000; Fox et al. 2005; Braunstein and Welch 2002). A broad range of financial, consumer and educational institutions are now providing programmes targeted at both students and adults, most of which have been launched within the past decade (Fox et al. 2005). These programmes are augmented by a wide array of popular financial books and guides, covering topics such as financial planning, investment management, and management of personal finances, insurance, and tax planning.

In contrast to the focus on financial literacy by a broad range of providers in an increasing number of developed economics, it appears limited attention has been paid to financial education in the context of poverty reduction programmes in developing countries (see Piprek et al. 2004; Sebstad and Cohen 2003).
**Attitude to money**

In developed economies money takes a variety of forms and has a variety of often conflicting meanings. Money has become a primary (if not the primary) measure of value — including a measure of self-worth (Gresham, Austin and Fontenot 1989). Conversely, money is also widely regarded as the 'root of all evil'. Concurrently, however, additional money is commonly considered a means of solving many everyday problems. In contemporary Western society 'money is probably the most emotionally meaningful object in contemporary life; only food and sex are its close competitors as common carriers of such strong and diverse feelings, significances, and strivings' (Kreuger 1986:3).

In developed economies people generally appear to have a positive attitude to money (Tang 1992, 1993, 1995). Money represents material success, not evil, and careful budgeting is generally valued. Attitude to money appears to be independent of a person's income (Yamashita and Temple 1982). Different ethnic and national cultures appear to hold different attitudes to money (Furnham and Argyle 1998:48).

Little attention has been paid to attitude to money, and the meaning of contemporary money, in developing economies. However, given the importance of money in developed economies and the significant influence money can have in determining financial competence, it is likely attitude to money will also be important in developing economies — in particular as monetisation spreads. It is also likely that attitudes to money in developing countries will also be affected by current and prior experiences with money and the individual's level of financial knowledge and skill.

**Financial competence**

Competent participation in the money economy requires an appropriate level of knowledge and skill, an appropriate attitude to money, and the adoption of positive financial behaviours (including financially inclusive behaviours), enacted within an accessible financial system trusted by those participating in the system. There are indications that a correlation exists between financial literacy, financial inclusion and standard of living (although the direction of causality is at present unclear). We can begin to construct a theory of financial competence relevant to poverty alleviation.

Financial competence can be conceptualised as a set of financial capabilities operationalised across a range of financial activities. Financial activities can be categorised. The categorisation adopted for the competency model discussed in this paper is that developed by the UK Financial Services Authority (FSA 2005).

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**Figure 1: A model of financial competence**

Financial Activity

- **Managing Money**
  - Component 1
  - Component 2

- **Planning Ahead**
  - Component 1
  - Component 2

- **Making Choices**
  - Component 1
  - Component 2

- **Getting Help**
  - Component 1
  - Component 2

**Knowledge & Skill**
- Behavioural Competence
- Financial Inclusion

**Financial capability**

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In order to perform a given financial activity, financial capability must be employed. Capability can be either latent (knowledge and skill) or enacted (behaviour). To be effective, capabilities must be deployed at an appropriate level of competence. An individual’s attitude to money will influence the financial capabilities utilised and the financial activities undertaken.

The Adult Financial Capability Framework developed by The UK Financial Services Authority and the Basic Skills Agency (FSA and BSA 2003), proposed three inter-related dimensions of financial capability/financial literacy: Financial knowledge and understanding, financial skills and competence, and financial responsibility. Importantly, the FSA/BSA framework introduced the concept of competence to the financial literacy/financial capability construct. Competence provides a lens through which to view the complex interrelationship between financial knowledge and skill, attitude to money and financial behaviour (including financial inclusion).

While competencies are situation specific, the set of competencies developed by the FSA and BSA does, however, provide a base framework for the determination and measurement of competence and the development of outcomes relevant for interventions to increase competence.

The principal drivers of change in financial competence are therefore a change in latent capability (knowledge and skill), a change in financial behaviour (including financial inclusion), and a change in attitude to money. This can be depicted as a set of relationships, as indicated in Figure 2.

A change in the overall level of an individual’s financial competence can therefore affect the individual’s economic well-being and subjective well-being (self-reported happiness). A change in the well-being of those in the household principally responsible for managing the household’s finances (both short-term and longer-term finances) can also, therefore, affect the well-being of those dependent on the individual. An increase in the financial competence of the principal financial actors in a household is therefore likely to positively affect the well-being of the household generally. This relationship will be mediated by a range of environmental factors (for example access to transport, environmental and political stability), socio-cultural factors (for example social obligations, socio-cultural conceptualisations of money/wealth, familiarity with contemporary money, and traditional modes of economic exchange) and individual factors (for example an individual’s level of functional literacy, habits and personal relationships).

We can illustrate this by way of example. Remittances are becoming increasingly important in several Pacific countries. A recipient of a remittance who has a low level of financial knowledge and skill is more likely not to have a bank account to receive the remittance or to place emphasis on deferred spending. Consequently the financial behaviour adopted is more likely to require receipt of the remittance in cash via informal transaction channels (with consequent higher costs) and there is a greater likelihood funds will be used for short-term consumption. Therefore there is more likely to be small impact on household economic well-being. Conversely a recipient of a remittance who has a higher level of financial knowledge and skill is more likely to have a bank account to receive the remittance and to place emphasis on deferred spending. Consequently it is more likely funds will be deposited directly to a bank account (with lower transaction costs) and funds will be split between immediate and deferred spending. Therefore it is more likely the remittance will lead to both an increase in household income and assets, as in Figure 4.

Intervening to enhance participation in the money economy is a potentially powerful tool in the alleviation of poverty. To be successful, intervention must encompass the ability to exercise control over money and the opportunity to exercise control over money. Two interventions are therefore required to improve the position of the financially excluded: a targeted programme to enhance financial knowledge and skill, and an accessible, trusted, financially inclusive environment.

The following is a brief example of a successful Pacific-based intervention to enhance both the ability and opportunity to exercise control over money by financially excluded rural villagers in Fiji. It illustrates how a well structured and targeted financial literacy and financial inclusion programme can be quickly and cost effectively developed and can achieve significant results within a relatively brief time frame.
Intervening to improve financial competence

Receipt of an international remittance

Little importance placed on planned use of money
Money received in cash
High informal transactions once with
duced net receipts
Money used for short-term consumption.

Recipient—low level of financial knowledge & skill

Attitude to money

Financial inclusion

Financial behaviour

Household wellbeing

Don't have a transaction account
Most receive funds informally in cash

High importance placed on planned use of money
Money deposited in bank account
Low informal transactions once with
duced net receipts
Funds split between immediate and
furred consumption/corssing

Recipient—high level of financial knowledge & skill

Has a transaction account to receive funds

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Rural banking in Fiji

The Republic of Fiji has a population of approximately 900,000. Close to 90 per cent of whom live on the two major islands, Viti Levu and Vanua Levu. Approximately half the population lives in rural areas many of which are remote with limited and difficult road access. Fiji has a well regulated and stable banking system.

Supply and demand for banking services in rural Fiji

There has been a progressive withdrawal of banking services from rural Fiji. The postal service which provides the principal means by which rural Fijians can access the banking system has reduced its outlets by an estimated 60-75 per cent in recent years.

Tebbut Research (2005), in a survey of the demand for banking services in rural Fiji, undertaken for the Reserve Bank of Fiji found that, while bank and non-bank savings are low, the demand for savings services is high (demonstrating a positive attitude to deferred spending). The low level of financial inclusion in rural Fiji is clearly due to supply rather than demand factors.

Government and Reserve Bank intervention

Concern about the lack of banking services in rural areas mounted during the 1990s and the 1999 Committee of Enquiry into Financial Services recommended action be taken. In 2001 the Reserve Bank of Fiji established a working group with representation from the Reserve Bank and the commercial banks. Research was initiated and consideration given to the establishment of a fund for rural banking services to be funded by a required contribution by the commercial banks of one per cent of their profit.

'Banking the unbanked' initiative

ANZ Bank, a multinational bank with long established operations in Fiji determined it would independently investigate whether it was feasible to extend financial services to rural areas. ANZ’s business was focused primarily on commercial banking and urban retail banking through a network of 16 branches. There was no representation in remote rural areas. ANZ had an approximate 40 per cent market share of banking activity in Fiji. In late 2003 ANZ undertook a feasibility study to determine the potential to extend into rural areas. The study concluded a potential market existed which could be profitably and sustainably served. ANZ estimated the potentially accessible market to be as many as 250,000 people.

The ANZ project manager established a network of collaborators. These included village elders, the Reserve Bank of Fiji and the UNDP who, having previously supported a range of Grameen replication microfinance initiatives in the Pacific, had adopted an inclusive financial sector approach (Liew 2006) within the wider context of UNDP’s engagement with the commercial community (Commission on the Private Sector and Development 2004). UNDP had recognised the need to facilitate an increase in the financial literacy of rural communities in Fiji, but also recognised that increased literacy required the concurrent opportunity to utilise knowledge and skill through participation in the formal financial system.

The solution developed was simple: financial literacy training combined with mobile rural banking. To ensure sensitivity to environmental and socio-cultural factors, the local community was, and continues to be, a key partner in the initiative. Villagers, in particular village elders, were directly involved in the development of both the financial literacy training and the rural banking service.

Financial literacy

Working with a range of local participants, UNDP developed a financial literacy training programme. The training model was developed to suit the rhythm of village life. UNDP contracted training to the microfinance unit of the National Centre for Small and Micro Enterprise Development. Training is conducted in the local language and is undertaken concurrent with, but independent to, the provision of the rural banking service. Training is conducted on a group basis, with delivery in situ, usually in the village.

Financial inclusion

The banking product range is specific to the customer base and delivery model. Two savings products are offered. Both pay interest on deposit balances with one account charging a monthly account management fee. Field operation of the accounts is not system dependent. The accounts are passbook based and manually updated. An individual micro loan is also offered. Dedicated bank staff provide frontline services and back office coordination. Standard account management and voucher processing processes are used. There is significant commitment by bank staff to the rural banking service, despite the longer working hours and extensive travel over frequently marginal roads.

Outcomes

The banking the unbanked initiative has achieved significant results within a short time span. There are approximately 1,200 formal villages and 500 settlements in Fiji. A significant number of villages and settlements are located in rural areas. A programme has been implemented to provide financial literacy training to 250 rural villages over a 1.5 year time frame at a pace of approximately three villages per week. To date financial literacy training has been delivered to 130 villages (this is in addition to the 120 villages to whom training was delivered during the pilot
phase of the project). Two training models are used: a direct and a cascade model. Trainers from the microfinance unit undertake training as part of their regular village visitation programme and also train trainers from provincial councils who subsequently undertake training in villages.

Rural banking operations commenced October 2004. During the first 12 months of operation 40,000 new deposit accounts were opened at an average of one account per customer. ANZ estimates 98 per cent of accounts have been opened by customers without a current bank account. The initial focus has been to build the deposit account base. Increased emphasis is now being placed on micro loans.

In the 18 months since inception, the rural banking service has provided outreach to 14 per cent of the estimated 300,000-350,000 people in rural Fiji who do not have a convenient and secure means of managing money. On current trends the outreach will have extended to approximately 18 per cent and could potentially reach between 34-40 per cent within three years.

The financial literacy and financial inclusion initiative has now been extended to the Solomon Islands and research is underway to determine the feasibility of extending to other jurisdictions in the Pacific.

Summary
In a globalising economy, the opportunity to participate in the formal money economy and the ability to manage money are basic freedoms. Competent participation in the money economy requires an appropriate level of knowledge and skill, an appropriate attitude to money, and the adoption of positive financial behaviours, enacted within an accessible and trusted financial system.

Interventions to increase financial competence are a potentially powerful tool in the fight against poverty. To be successful an intervention must encompass both the ability to exercise control over money and the opportunity to exercise control over money. A well structured and targeted financial literacy and financial inclusion programme has the potential to achieve results within a relatively brief time span.

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