Financial Well-being

What counts

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We have taken great pains to explain why, if we want to transform the lives of individuals, we need to change our focus from financial wellness or financial capability to financial well-being. Similarly, we have argued that if we can navigate the decision-making minefields thrown up by our filters of automatic thinking, social context, mental models and mindsets about money, then striving for financial well-being becomes a meaningful pursuit. But unless we can demonstrate that this approach indeed makes a difference, financial well-being becomes one more piece of marketing puffery.

In this third chapter we tackle this issue of measurement from a variety of angles. Each year, millions are spent around the world on employee assistance programmes and wellness programmes in the workplace. And this is no different in South Africa. Employers the world over recognise the importance of providing these additional benefits to their workers because of the direct impact that they can have on their bottom line, through reduced turnover and increased productivity. If we are not assessing whether we are getting measurable improvements, then there should be serious questions around whether there is merit in investing in these exercises.

In *Benefits Barometer 2014:*'Failure to launch' we reported that interventions to improve financial literacy had a mere 0.1% impact on changing financial behaviour.

Here were some of the identified stumbling blocks:

- Recognising that for most companies, programmes will have to address a range of literacy levels and needs – one size can simply not fit all and expect to be effective.
- Addressing the fact that individuals may be at different stages of receptiveness to change and that effectively reaching these different levels requires very different types of interventions.
- Knowing whether the programmes and services provided are actually translating into better decisions or less stress for employees.

Our last point represents the crux of the matter. If we are not assessing whether we are getting measurable improvements, then there should be serious questions around whether there is merit in investing in these exercises.

Setting a base line

From the government's perspective, their primary interest in measuring financial literacy and skills was to understand how South Africans compared to their cohorts in other countries. If they could establish some sort of baseline skill levels for South Africans today, they could assess whether interventions from either the public or private sector were actually impacting that baseline (either positively or negatively). As such, the concept of financial capability held the greatest relevance for this type of assessment.

In *Benefits Barometer 2014:* **'FSB study on financial literacy in South Africa overall score for each measurement area, 2011-2012'**, we reported on the work of the Financial Services Board (FSB) as part of an initiative with the OECD task team on financial education. Their findings formed the foundation of the financial competency framework that aims to improve the quality of financial education intervention in South Africa. Within this framework, the FSB sets out four domains described below.

These are indices against which you can measure knowledge. They point out actions of a consumer that indicate financial competence and include examples of the types of programmes and presentations that may be effective in developing high financial literacy among consumers.

The diagram gives a brief summary of the four domains:

1. **Financial control**
   The objective is to manage current expenditure
   A financially capable person exercises a high level of control over their finances and is able to save rather than spend, budget and make ends meet, and is involved in the daily decision-making for the household.

2 **Financial planning**
The objective is to manage future income and expenditure
Here a person must set financial goals and commit to meet them, display a preference for long term saving, and have emergency funds in place.

3 **Financial product choice**
The objective is to choose the right financial products
A consumer must understand financial products. They must be aware of different types of banking and insurance products, hold at least one of a range of financial products, must have a clear understanding of their product needs, undertake detailed research before choosing a product, and must have no regrets about the products they've purchased in the last year.

4 **Financial knowledge and understanding**
The person must attain and increase mastery over personal finances
This is a consumer with high financial knowledge and an understanding of some of the familiar financial concepts, including basic mathematical division, effects of inflation, interest paid on loans, interest on deposits, compound interest, risks involved in high-return investments, risk and diversification.

Despite the fact that the FSB describes their objective as developing the financial literacy of South Africans, what it describes in this framework goes beyond financial literacy to developing financially capable consumers.

Financial capability is a construct that extends our understanding of financial concepts as to how we manage our finances and make financial decisions. Policymakers and academics have used the term to refer to a person's ability to manage the demands of personal finance[1]. Financial capability is the ability to sustain these abilities once they have been achieved. It creates the platform of good decisions which allow financial well-being to be reached.

> **Many individuals exhibit the right behaviours without necessarily having financial literacy.**

The challenges of measurement

Given the financial competency framework set out by the FSB, measuring financial capability would seem to be relatively easy. A series of surveys can test knowledge of financial terms, an inventory of a person's product holding can tell you whether they have the right products and a quick look at their budget will tell you whether they are both using current income wisely and planning for future expenditure. You can use all this to calculate a score for the four domains described earlier.

But there are two problems with this approach:

1. Combining the scores to form a single number for how financially capable someone is may be tricky. The four domains bear little relationship to each other, since doing well in one category doesn't affect how well someone does in another category[2]. This is evidenced by the fact that although conventional measures of financial capability are predicated on the belief that financial literacy translates into the right behaviours, the World Bank has pointed out that many individuals exhibit the right behaviours without necessarily having financial literacy[3]. An individual may have an excellent level of financial literacy and knowledge but the types of blockages described in the previous chapters prevent them from translating this into the right behaviours[4].
2. No two people will have identical financial profiles. They may have the same family structure, income and fixed monthly expenses. But one of them may have a family history of illness that puts them at greater risk of financial loss than the other person. We cannot measure the two using the same benchmark.

Like the FSB, the CFPB in America conducted an extensive study on financial well-being in order to determine how to define and measure the success of different financial literacy strategies so that they have a basis for measuring the effectiveness of different strategies' effectiveness.

Some of the problems they identified in how practitioners have been measuring the success of their interventions includes[5]:

- Although there is a lot of work on how financial knowledge correlates with certain factors, little has been published on the causal relationship between financial knowledge and financial behaviour.
- Concepts that are being measured, whether financial knowledge, financial well-being or some other objective, are loosely defined.
- The studies fail to combine large samples, long time-spans and control populations that would contribute to meaningful conclusions on the subject.
- Well-being is sometimes conflated with behaviours that are considered to be positive because they are presumed to lead one in the direction of financial well-being.

Attempting to measure financial well-being unearths a new set of challenges, mainly that financial well-being has never been explicitly and consistently defined, nor is there a standard way to measure it[6]. Although we offer a definition of financial well-being in this publication, it relies on every individual's subjective assessment of the complex interaction between whether:

- they have sufficient resources, both financial and knowledge-based
- they feel secure both now and in the future
- they can achieve their financial and nonfinancial goals

- they have options available to them.

Additionally, what we've described relies quite heavily on time. It requires us to follow an individual through time and at each point ask them whether they have achieved financial well-being. It may require us to only ask this question at the close of a person's life. No industry practitioner would be excited about only measuring the success of their project 20 or 30 years after the intervention was applied.

So the best the adviser can do is help an individual make an accurate assessment of where they are, given that the world is evolving so fast. For instance, while automobile insurance may play an important protective role today it will be irrelevant in a future where sharing systems, like Über dominate.

If financial well-being is so difficult to measure why should we even bother? We bother because we need to understand better. Although we propose a number of concepts that practitioners may find intuitively appealing, we have no way of knowing whether anything we've put forth is actually addressing our end-game. Constructively contributing to the ongoing debate demands measurement and monitoring.

We start the measurement process by looking first at financial capability.

Individualising financial capability

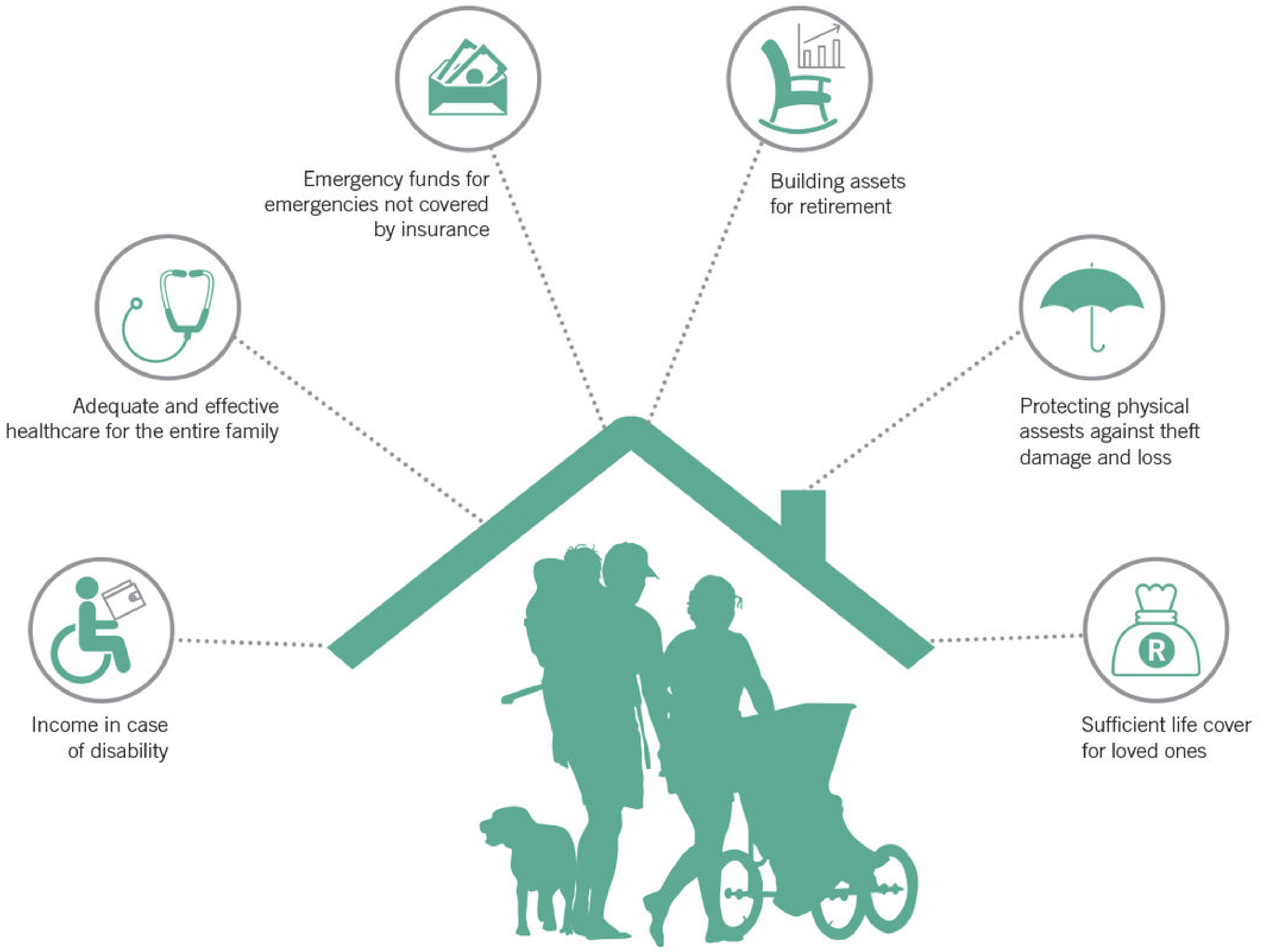
Let's start with our first two criteria: does the individual have sufficient resources, both financial and knowledge-based, and is the individual and their family secure both now and in the future?

To address these first two concerns we need a high level structure, an interactive tool, that addresses four areas of assessment:

1. Determine the areas of a person's life that could give rise to financial loss.
2. Establish a set of benchmark criteria that is specific to the person we are interested in assessing.
3. Assess how much cover the person needs.
4. Compare this to how much cover the person has, if any, in that area.

Determining the areas of a person's life that can give rise to financial loss means we need to consider both their life and asset-related risks. Life risks include their probability of death, while asset risks could be the loss of a car. Such risks do depend on the state of health of the individual and their personal store of assets. What's important is that the assessment should not only take place at an individual level but at a household level. The tool needs to take account of where financial loss can come from, including healthcare needs of children, for example.

The diagram describes some of the areas that we may be interested in considering:



The household's areas of financial concern

A single male with two children will find that life cover ranks very highly.

We would have to establish a set of benchmark criteria specific to the person we are interested in assessing. This might mean looking at certain demographic characteristics like sex, age, education and possibly even values, attitudes or habits[7]. The aim here would be to establish, based on research, which areas of financial concern would need to be covered and with what level of priority. For the example given before, the person who is paying off their car will have to prioritise short-term insurance that covers that vehicle because the loss of the car could have terrible consequences.

The level of priority given to each area will change depending on demographics. A single male with no dependants will not need to prioritise life cover, but a single male with two children will find life cover ranks very highly.

For a low-income earner, their priorities, in order, should be ensuring that they can make ends meet (setting up a budget), having an emergency fund and then ensuring adequate protection against the risks that are not covered by the state (funeral insurance, short-term insurance, life cover and retirement savings).

Other concerns, like medical coverage and education, are provided for by the state, so low-income earners don't have to pay too much attention to this. Although retirement income is also provided by the state, it is at such a low level that it would be wise to supplement this with savings.

Next we need to assess how much cover a person needs. This involves an assessment of how much insurance or liquid assets they would have to hold to make sure that they are covered for any financial loss. We might want to know the person's income, liabilities and assets to correctly assess how much protection they need in each area.

Finally, we compare this to how much cover, if any, the person has in that area.

To find the 'funding level' in each area, we need to take the ratio of what the person has to what they need to be fully protected. The final score that we calculate is then a weighted average, weighted by the level of priority of each area, of the individual funding levels.

What the tool does is ensure that the individual has enough financial protection in each area so that any mishap, expected or unexpected, does not set them back financially. It does so by pointing out possible areas where insufficient protection has been set against the risk that the person faces.

> **Individuals should have the freedom to adjust their priorities to suit their own needs. If our tool can evolve with the individual in an interactive way then we will have come as close as possible to achieving our well-being agenda.**

Should we be using the same benchmarks for everyone?
Using a set of priorities based on demographic and family factors may work for some. What it does is provide a useful starting point for individuals who may not even know what steps to take to achieve financial capability. But not everyone sees the same value in formal protection mechanisms like insurance products, specifically lower income earners who are dealing with much more complex issues than middle- and higher-income earners. So they should have the freedom to adjust their priorities to suit their own needs.

As such, if our tool can evolve with the individual's priorities in an interactive way, then we will have come as close as possible to achieving our well-being agenda.

What we've done here is addressed the issues of 'feeling secure' and setting a floor for quality of life, while at the same time recognising that our finances need to help us expand our range of choices.

How could an employer benefit from this framework?
In previous *Benefits Barometers* we made the case for why employers need to care about financial health. We've also discussed examples of ways to measure the return on investment of financial education and financial wellness programmes in the workplace. The tool described above can take the measurement to a whole new level.

By looking at the scores individuals achieve on an aggregated basis, an employer can get a feel for the areas that people are struggling with and that could be a potential concern in future. For example, if there are several employees spending more than they earn every month, the employer could be facing a debt crisis among employees. Measurement at the employer level can highlight issues before they turn into problems.

What this tool can assist with is the optimal structure of employee benefits packages within the constraint of affordability. By matching the demographic and family profile of employees with the benefits that would serve them best, the employer can offer a package of benefits that plugs some of the holes that people may have in their financial protection, potentially without incurring additional costs, if they replace existing benefits that are of little value to their employees.

Slicing and dicing the data may allow the employer to target assistance to those employees who have the greatest need.

Measuring financial well-being

Measuring financial well-being involves pulling in the final two points from our definition given earlier, namely:

- whether they can achieve their financial and non-financial goals
- whether they have options available to them.

We have described how we can measure an individual's financial capability, but to measure financial well-being we need to think more about what matters to each individual.

The goals that an individual may set for themselves may be nebulous, like trying to achieve financial security. But in one way or another every person's goals and aspirations are related to their financial ability to meet those goals. To assess whether a person has achieved a high level of financial well-being we need to structure protections and financial decision-making around the end-goal that we have in mind. This means that we select our protections so that a life-changing event does not get in the way of our ability to meet our goal.

To make the goal more tangible and easy to assess, we might also specify an amount of money that we need to meet the goal and a time frame within which to achieve the goal.

We are attempting to measure how effective our financial capability is at getting us to our personal goals. And if we are able to both score highly on financial capability and achieve the goal that we have set for ourselves, then we should be financially 'well'.

It may be difficult for an individual to specify their goal clearly or even to specify the right goals, one that genuinely improves their financial well-being rather than one that is unrealistic and creates financial stress. This is where various stakeholders, like financial coaches, can play a role in helping people to articulate their goals. The assessment framework and goal-setting mechanisms form a roadmap that individuals can use to navigate their financial well-being.

> **Essentially we are attempting to measure how effective our financial capability is at getting us to our personal goals.**

Concluding thoughts

Financial well-being is a concept that is not easy to define or measure. But industry practitioners can offer individuals a way to assess their well-being that both relies on the individuals' level of financial capability and their ability to meet certain milestones in their life, like buying their first home.

But we need some way of knowing whether our interventions are successful. Providing an assessment framework that understands that person's priorities and the options they have available to them is the first step to understanding whether they are achieving financial well-being.

References

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Article tags

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