

Determinants of Financial Capability: A Situational Analysis for Namibia

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Abstract: It is imperative that if the poor in society benefit from the massive developments in the financial sector, then such a sector must be genuinely inclusive. It should meet the needs of all citizens with the potential to use such financial services productively. This paper scopes financial inclusivity as a process ensuring ease of access, availability, and usage of financial services by all members of society. To reduce socio-economic inequality, the poor in developing countries, like everyone else, need access to a wide range of financial services that are convenient, flexible, and reasonably priced. Therefore, financial inclusivity is sought to be significant towards the global development agenda as a tool for increasing the poor's access to financial services, often cited as a mechanism that can help reduce poverty and lower income inequality. For many years, microfinance has been heralded as a mechanism for enhancing financial inclusion. It provides an avenue through which the marginalized and the poor can access and benefit from the formal financial system. Moreover, financial inclusivity is substantially evident in the rural areas among the poor, who have no collateral or credit history for participating in the legal financial system. As a result, financial inclusion is receiving increased attention as an essential tool for reducing aspects of socio-economic inequality characterized by the isolation of individuals and communities from formal financial services, like affordable and accessible credit.

Keywords: Financial Inclusivity; Financial Capability; Financial Knowledge; Inequality.

1. Introduction

The extent of an individual's financial literacy and access to essential financial services influences their financial capability, stability, and well-being. This is more so in environments characterized by high uncertainty and frequent cyclical financial market volatilities. This was witnessed in some recent global financial crises, which highlighted the significance and importance of financial knowledge and skills for consumers (Šoškić, 2011; OECD INFE, 2012). According to FINRA Investor Education Foundation (2009), the financial landscape has undergone sea changes; for example, concerning pension plans, the shift from defined benefit plans to defined contribution plans, among others. This has transferred the burden of providing an income stream at retirement from employers to individuals. This dismantling of financial intermediation function and the proliferation of financial products and services have severe financial implications for households as retirees are now made responsible for their future financial well-being. To navigate the complexities of financial terrain, they will require financial forecasting and planning skills to operate in the financial services market effectively. According to Vyvyan et al. (2014), the increased marketing, access to credit, accelerated technological change, and a greater variety of investment and financial products make the

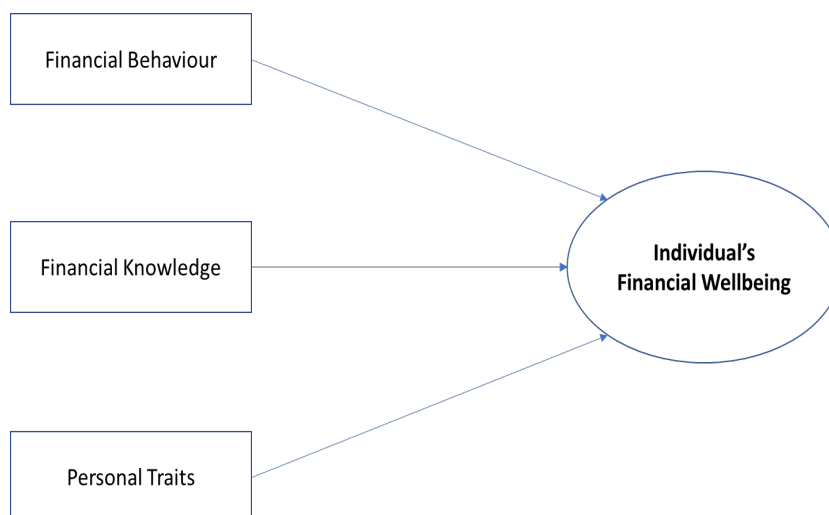
process of personal financial decision-making more complex and challenging. In this context, financial education has become increasingly important for individuals to ensure their individual financial well-being and facilitate the smooth functioning of financial markets and the economy (Organisation of Economic Cooperation and Development (OECD), 2005).

2. Individual's Financial Well-Being

The theoretical underpinning of financial literacy is supported by the microeconomic intertemporal approach to saving and consumption decisions and the human capital theory. According to Lusardi and Mitchell (2014), the intertemporal approach to saving and consumption theory posits that an entirely rational and well-informed individual will consume comparatively less than their income in periods of high earnings, thus committing to support consumption in posterity. Alternatively, the human capital approach to financial literacy projects the acquisition of financial knowledge as a type of investment in human capital. It depicts those who build financial savvy to have the capacity to earn above-average expected returns on their investments, unlike in other investments. However, according to Lusardi and Mitchell (2014), the human capital approach to financial literacy would suggest substantial individual differences in financial knowledge and economic behavior, implying that this approach is unlikely to enhance financial well-being for everyone.

Several studies have supported financial education as a prerequisite for building necessary financial literacy outcomes such as financial knowledge, financial dispositions, and financial behaviors. However, it is still unclear which policy mix is more effective in achieving these goals. According to Gutter, Wang, and Way (2007), a successful financial education policy would ideally produce students with high levels of financial knowledge, positive financial dispositions, and positive financial behaviors. Bureau (2015) agrees with this conceptualization as pointed out in their report that the ultimate measure of success for financial literacy efforts should be improved individual financial well-being. The report proposes three factors to drive an individual's financial well-being: financial behaviors, financial knowledge, and personal traits.

Figure 1: Individual's Financial Well-Being



Source: Review of Literature

3. Situational Analysis of Namibia

According to the Africa Economic Outlook (2012), in Namibia, the finance, real estate, and business services sector contributed 26.5% and 28.7% of GDP in 2006 and 2010, respectively, ahead of any other industry. Besides, according to the Namibia Labour Force Survey (2015), Financial and Insurance activities employed 2.1% of the labor force. These statistics indicate that the financial sector plays a crucial role in the Namibian economy regarding employment creation and contribution to GDP. The financial sector in Namibia appears to be stable; however, it is not without challenges. Weaknesses characterize the industry. These include limited competition and a high concentration of majority-owned South African commercial banks, defective financial products primarily in the bond market, a relatively illiquid secondary market, and limited trading on the Namibian Stock Exchange (African Development Bank, 2014). In addition, the current business model in which NBFIs' deposits are the most significant funding source for banks denies commercial banks deposits from the public. These limit access to finance for small and medium enterprises (SMEs) and the general public, underlies the need for consumer financial literacy. According to FinScope Survey (2011), the proportion of the financially excluded population in Namibia has fallen from 51.7 percent in 2007 to 31.0 percent in 2011. This evidence suggests the need for further engagements with financial literacy and capability initiatives.

4. Financial Capability

There is general agreement that citizens who make sound financial decisions and interact effectively with financial services providers stand a chance to achieve their financial goals and therefore improve their household's welfare (Perotti et al., 2013). Besides, financially included citizens contribute to financial sector development, which relates positively to economic growth (Kubicková, Nulicek, & Jindrichovska, 2019). Incidentally, these are the twin objectives of financial capability initiatives. It is essential to reflect on the concept of financial capability, which has two-dimension, financial literacy, and access. Several definitions have been offered for financial capability. The UK Treasury (2007), for example, conceptualizes it as a person's ability to manage money well, both day to day and through significant life events, including periods of financial difficulty. It is influenced by personal skills, knowledge, attitudes, and motivations and made possible by an inclusive financial system and supportive social environment. While Miller et al. (2014) differentiate the two terminologies by suggesting that financial literacy reflects the increase in consumers' financial knowledge, while financial capability reflects skills, attitudes, and behavior change. Financial literacy is understood as the outcome of sharing information. Johnson and Sherraden (2007) argue that financial literacy is helpful but insufficient for developing financial capability. In reference to the capability theory, people should be enabled to maximize life chances by fully participating and leading economically rewarding lives (Sen, 1993). This approach implies the availability of adequate opportunities for people to engage in desired activities and develop behaviors to become who they want to be (Robeyns, 2005). Distinct from the human capital theory, the capability approach to financial literacy is not purely individualistic. Instead, it takes into account the external environment and array of opportunities open to a person, as well as that person's internal capabilities. The capability approach requires acquiring knowledge, competencies, and the ability to act on that financial knowledge and an opportunity to perform, which is financial capability. Vyvyan et al. (2014) suggest that financial capability has two broad themes: acquisition of financial knowledge and skills, which represents financial literacy, and removal of institutional barriers to enhance financial inclusion, access to financial services. OECD (2005) comprehensively provides an understanding of financial education as consumers' understanding of financial products and concepts and, through information, instruction, and objective advice, the development of skills and confidence to deal with financial risks and opportunities, make informed choices, and ultimately know where to go for help. Further

following Financial Services Authority (FSA) survey in Taylor (2011), this study explicitly identifies five domains of financial capability in Britain that contribute to financial capability: making ends meet, managing money, planning, choosing products, and staying informed.

4.1 Building Blocks of Financial Capability

Globally, financial literacy has been embraced in national policy initiatives. However, its potential for making people capable of managing their finances is doubtful. According to Sherraden (2013), it is unclear whether financial literacy will reduce financial vulnerability in low-income households if institutional barriers to beneficial financial products are not simultaneously addressed. Conceptually, financial capability includes financial literacy and extends financial literacy to cover institutional barriers facing low-income households, an aspect of financial inclusivity. Besides, consumer financial capability has been noted to use appropriate financial knowledge and perform desirable financial behaviors, including earning, spending, borrowing, saving, and protecting, to improve economic well-being (Xiao, 2016). The concept has been researched from a behavioral economics perspective; accordingly, financially capable consumers plan, find and use information, know when to seek advice, and can understand and act on advice, leading to greater participation in the financial services market (HM Treasury, 2007, p. 19).

Further, McQuaid and Egdell (2010) conceived a financially capable consumer as being able to deal effectively and confidently with the daily management of finances, planning, efficiently select financial products, and services, know where and how to seek financial advice as well as the motivation to affect personal financial changes. Similarly, according to Johnson & Sherraden (2007), financial capability requires both the ability to act, which is embedded in knowledge, skills, confidence, and motivation and the opportunity to act, reflecting access opportunities to beneficial financial products and institutions. Therefore, both ability and opportunity contribute to a person's financial well-being and life chances. This points to another conceptual understanding of financial capability, the life-cycle approach.

According to Lusardi and Mitchell (2014), the intertemporal approach to savings and consumption decision-making posits that an entirely rational and well-informed individual will consume comparatively less than his income in periods of high earnings, thus saving to support consumption posterity. Using the life-cycle model, Lusardi and Mitchell predict that financial literacy is endogenously determined over an individual's life cycle. The idea is consumers would be motivated to invest in financial knowledge to the point where their marginal time and money costs of doing so are equal to their marginal benefits. Thus, suggesting that consumers who receive financial education would have higher chances of enhancing their financial abilities to manage their money and perform financially better than their counterparts who do not receive financial education.

4.2 Supporting Theories of Financial Capability

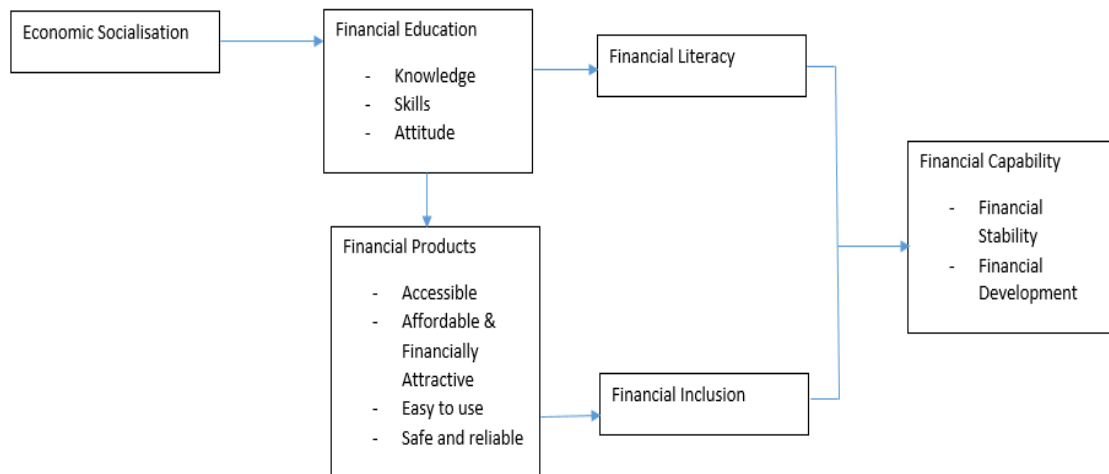
Central to the study of financial capability is the need to understand how consumers develop desirable financial behaviors which enhance their economic well-being. Underlying the financial behavior of individuals is a set of complicated motivators and drivers that cannot be observed explicitly. According to Xiao (2016), there are several theories for understanding and helping consumers develop desirable behaviors, including the theory of planned behavior and the transtheoretical model of behavior change. These theories have been used to study adult financial capabilities. For example Vyvyan et al. (2014) used the theory of planned behavior (TPB) to identify background factors, attitudes; normative influence; and perceived behavioral control to explore Financial Counsellors' Perspectives on financial capability in Australia. Gutter, Wang, and Way (2007), using Social Cognitive Theory which suggests that individual behavior is an interaction of personal factors, behavioral attributes, and the environment built a model that included the interaction of demographic characteristics, financial resources, social learning, financial disposition, financial knowledge, financial education policy

intervention, and financial behaviors. Similarly, Atkinson et al. (2007), in a baseline survey to establish the level of adult financial capability in the UK, used five domains of financial capability factors featuring managing money, planning, choosing products and services, and staying informed as significant determinants of successful capability policy intervention.

Financial capability is a relative concept, implying it can define a basic level of financial capability required by everyone in a given society (Kempson, Collard, & Moore, 2006). Beyond that level, the degree and nature of the financial capability required by an individual will depend on their financial circumstances. This would provide a universal reference point, or floor, which all individuals need to survive. In an ideal world, 100% of the population would be expected to attain this basic financial capability.

According to Basic Skills Agency (2004), the basic financial capability has nine components: different types of money/payments; income generation; income disposal; gathering financial information, and record-keeping; financial planning – saving, spending, budgeting; risk and return; personal choices and the financial implications; consumer rights, responsibilities, and sources of advice; and implications of finance. Kempson, Collard, and Moore (2006) reclassified these nine components into three significant factors: knowledge and understanding, which includes different types of money/payments, income generation, income disposal; financial skills encompassing gathering financial information and record-keeping, financial planning – saving, spending, budgeting; and attitude. The attitude component includes an individual's willingness to invest time and other resources required to apply their knowledge and skill; access information, advice, and other resources; and confidence to exercise their skills and act on the results. Several studies have been used to explore financial capability both in developing and developed countries (e.g., Zhou, Feng, H. & Gaile, 2018; Nanthuru, Pingfeng, Guihua, N. & Mkonya, 2018).

Figure 2: Financial Capability



Source: Sherraden (2010)

It is imperative that if the poor in society benefit from the massive developments in the financial sector, then such a sector must be genuinely inclusive. That is, it should meet the needs of everyone with the potential to use such financial services productively. This argument is supported by Sarma (2008), which views financial inclusion as a process ensuring ease of access, availability, and usage of financial services by all members of society. Besides, Helms (2006) suggests that the poor in developing countries, like everyone else, need access to a wide range of financial services that are convenient, flexible, and reasonably priced.

Recently financial inclusivity has received attention in the global development agenda as a tool for increasing the poor's access to financial services, often cited as a mechanism that can help reduce poverty and lower-income inequality (Park & Mercado, 2015). For many years, microfinance has been heralded as a mechanism for enhancing financial inclusion. It provides an avenue through which the marginalized and the poor can access and benefit from the formal financial system. However, according to Ghosh (2013), microfinance that once lauded intervention as the silver bullet to solve the problems of development and poverty reduction is currently ridiculed as the forerunner of financial instability and enhanced vulnerability among the poorest people. This implies that the issues of financial exclusion substantially remain in the rural areas among the poor who have no collateral or credit history for participating in the formal financial system. As a result, financial inclusion is receiving increased attention as an essential tool for reducing aspects of socio-economic inequality characterized by the isolation of individuals and communities from formal financial services, like affordable and accessible credit (Mellor & Affleck, 2006).

5. Conclusion

In a nutshell, the development of financial capability, stability, and well-being is highly aligned with the dynamics of financial literacy and access to basic financial services. However, it becomes difficult for individuals to make a personal financial decision due to increased marketing, access to credit, enhanced technology, and varieties of investments and financial products. Thus, the essentiality of financial literacy, supported by several studies, equates to a prerequisite for building adequate financial knowledge, financial dispositions, and financial behaviors. In Namibia, the financial sector plays a crucial role in the economy through employment creation and significant contribution to GDP. Nevertheless, the industry suffers heavy competition. A high concentration of majority-owned South African commercial banks, defective financial products, especially in the bond market, a relatively illiquid secondary market, and limited trading on the Namibian Stock Exchange deters access to finance for SMEs and the general public. Hence, it underlies the need for consumer financial literacy. Over the years, financial literacy has been globally embraced in national policy initiatives. However, its potential for making people capable of managing their finances remains doubtful. Thus, it remains unclear whether financial literacy has the potential to reduce financial vulnerability in low-income households without addressing the institutional barriers to beneficial financial.

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