What is financial confidence, and how can we improve it?

There is a robust and growing body of evidence which shows a strong relationship between financial confidence and financial wellbeing. In the 2018 UK Financial Capability survey, financial confidence was strongly correlated with current financial wellbeing, and there were similar findings from national surveys in Norway and Canada. However, the exact nature of the relationship between financial confidence, behaviour, knowledge and skills remains unclear.

This review summarises the latest evidence on the complex and multi-directional relationship between financial confidence, behaviour and wellbeing – and concludes by considering how providers can improve financial confidence.

How has financial confidence been defined and measured?

There is no agreed definition of 'financial confidence'. Several national financial capability surveys have developed distinct but overlapping measures of financial self-confidence, which are summarised in an accompanying 'Measures of Financial Confidence' document, and broadly cluster around three key concepts:

- Self-efficacy: whether people believe they can make effective financial decisions;
- Self-assurance: whether people believe in themselves, to act and follow through on those decisions;
- Self-determination: whether people have the intention and willpower to take control of their finances.

Some studies go beyond narrow measures of self-confidence, recognising that trust and confidence in the wider financial system fundamentally informs financial decision-making. Research by the OECD found that perceived 'risks' in the financial system – such as the risk of digital fraud or a lack of transparency – can undermine people's confidence in the system, discouraging them from making financial decisions and choosing financial products. Further work is needed to understand how financial self-confidence interacts with confidence in the financial system to shape people's behaviour.

Who lacks financial confidence and why?

Low financial confidence is more prevalent in financially vulnerable households, among young adults, particularly young women, BAME groups, unemployed people and private renters. Low levels of financial confidence are also seen among those with below-average financial capability (who tend to be under 35, single, social tenants, unemployed and with no educational qualifications). Perhaps unsurprisingly, financial confidence increases with age.

Several studies have demonstrated a link between financial confidence and current financial circumstance:

- The Money and Pensions Service's segmentation of UK adults found that 43% of financially 'struggling' adults and 46% of financially 'squeezed' adults do not feel financially confident, compared to 33% of the financially cushioned;
- The 2015 UK Adult Financial Capability survey found that only 32% of people who were struggling to keep up with bills reported feeling financially confident, compared to 54% of those who were not;

- Evidence from the Money Advice Service's What Works Fund showed that life events, which negatively impact financial wellbeing, such as unemployment, family break-ups, and bereavement, also affect financial confidence.

Financial confidence is also influenced by a wide range of factors beyond an individual's financial situation. Surveys of Financial Capability in Norway and Canada found that a person's experiences, circumstances and personality, as well as other psychological factors such as loss aversion (weighing losses as higher priority than equivalent gains) and inertia (capacity to act on an opportunity) all influence financial confidence. Levels of basic skills, including numeracy and digital skills, also shape financial confidence.

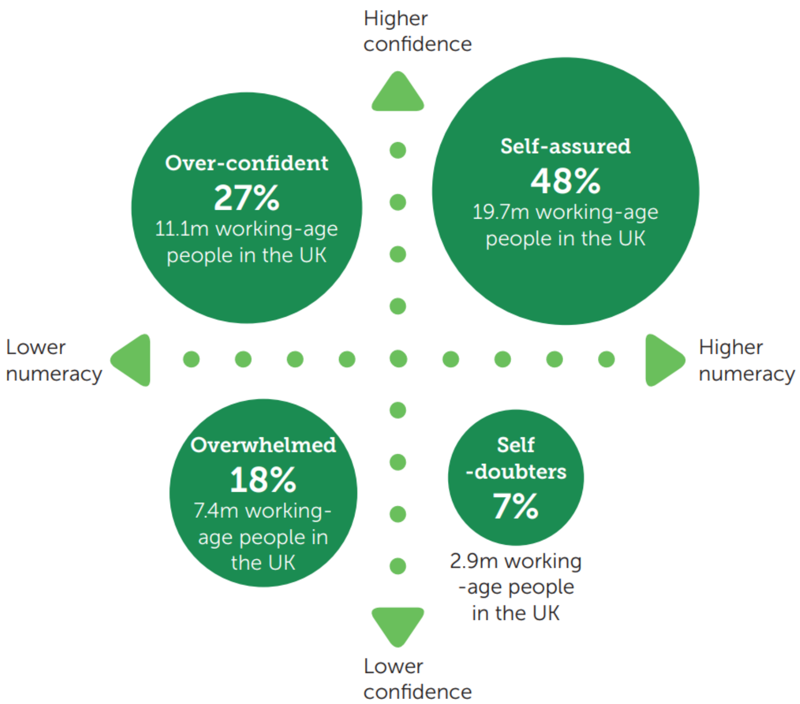
How does confidence relate to behaviour and ability?

Unlike the strong correlation with wellbeing, financial confidence is only a moderate predictor of certain financially capable behaviours: active saving, keeping track and shopping around. Other enablers – including spending self-control, engagement with money, and engagement with the future – are stronger predictors of a wider range of behaviours.

Confidence can be a good predictor of knowledge for people who are financially capable: research by the OECD on Adult Financial Literacy found that people who rated their financial knowledge as being higher than average were fairly accurate in their assessment.

However, there is not a clear linear relationship between financial confidence and financial knowledge and skills. Money Advice Service research exploring the link between financial numeracy and financial capability found that a large group of the adult population (27%, 11.1 million) are over-confident when using numbers - having high levels of confidence, but low levels of numeracy (see figure 1). This is then associated with riskier financial behaviours: people who are over-confident in their numeracy skills tend to believe they can manage their money well, despite making poorer financial decisions and being less able to understand financial documents or make everyday money calculations.

Figure 1: Confidence and numeracy in the UK adult population



(Source: Adult Numeracy and Financial Capability, Money Advice Service, 2018)

Over-confidence can also prevent people seeking help when they really need it. The Money Advice Service's 'Right Place, Right Time' research found that, in 37% of cases, people did not seek help when dealing with a life event because they were confident they could cope by themselves. This research demonstrated the critical role that confidence plays when people are deciding whether to engage with guidance.

Recent research from the US has shown that financial confidence can also mediate the effect of improved knowledge on people's behaviour, providing further evidence of the complex role that confidence plays in financial decision-making.

How can providers build people's financial confidence?

The Money Advice Service's What Works Fund has generated a significant new body of evaluation evidence about financial confidence. The findings below are mostly drawn from this evidence:

- **Clear, accessible financial education is key:** financial education can improve confidence, and is more effective when supported by experiential learning, such as carrying out a financial task with help from an advisor.
- **Establish rapport through one-to-one support:** delivering one-to-one support can build confidence, especially for young adults, for whom the relationship with their project worker is instrumental in developing their self-esteem and self-determination.
- **Address basic skills gaps first:** one study for people in retirement found that by improving people's digital readiness they could also develop their financial confidence, and maintain their engagement in the wider intervention.
- **Expect an initial fall in financial confidence:** there is a small amount of evidence to suggest that people's confidence can fall as they became more aware of gaps in their knowledge. This can be a positive finding, showing that the intervention is tackling over-confidence, but further work is needed to understand what a fall in confidence means for people's financial capability.

Crucially, these learnings are only applicable when beneficiaries acknowledge a gap in their skills, and actively seek guidance. However, low interest and engagement remain a critical challenge for providers of financial guidance, and this stems in part from issues of over-confidence: the key will be in learning how best to expose and tackle over-confidence, without switching people off to guidance.

Where should future research focus?

- Developing, and building a consensus around, a working definition of 'financial confidence' will support greater collaboration and focus on this topic.
- Related to this, it would be helpful to externally evaluate and/or validate some agreed, common measures of financial confidence.
- We need to further investigate the complex issues surrounding the influence of over-confidence on people's financial behaviour, and their propensity to seek support.
- More research is needed to identify transferrable learning for the financial sector from the extensive body of research on the psychology of self-confidence and self-efficacy.

What next?

Did you find this review helpful? We would like to know what you think. Please contact us at whatworks@fincap.org.uk with your feedback, and any suggestions for further research or evaluation that should be included in future updates.

This Thematic Review was produced in collaboration with the Centre on Household Assets and Savings Management (CHASM) at Birmingham University, the University of Edinburgh Business School, Toynbee Hall and Ecorys UK.