Ground-breaking evidence from the Kenya Financial Diaries indicates that households underestimate impacts of shocks that are not in the form of new cash outlays.

Households interviewed for the Kenya Financial Diaries* think about losses in terms of cash outflows. They generally have a good understanding of the direct costs of risks (i.e. money spent on expenses). However, they underestimate the impact of risks which do not result in direct cash outflows, but rather in lost income or assets.

For example, 63 per cent of respondents who experienced crop failure reported that the event had no impact on their household. They didn’t register the value of the lost harvest, lost cost of inputs, or lost value of labour. Only for a few risks – death of a main income earner, and temporary and permanent disabilities – did respondents report any lost income as a result of the shock.

Psychologically, underestimating losses may make it easier to face them, but it also makes it difficult to communicate the value of protection against these kinds of losses. The way people conceptualize losses shapes how they manage them, and by not acknowledging the full cost of risks, households are likely to inadequately prepare for them and not buy insurance.

Researchers in India, studying clients’ financial awareness, found a strong correlation between an understanding of probabilities (to estimate risk exposure) and the decision to purchase insurance [1]. By teaching farmers to estimate the full cost of risks through effective financial literacy programmes, providers (and policymakers) can help them make a more informed decision about which risks to prioritize. Further, providers can adapt the way they frame their offering to match the way that farmers think about losses (e.g. as avoiding hunger rather than as losing outputs).

The Kenya Financial Diaries have revealed a gap in understanding for potential insurance clients. What are the consequences of such gaps for farmers who do have insurance? Keep an eye out for our next Emerging Insight for some surprising results.

* Bankable Frontier Associates and Digital Divide Data conducted the Kenyan Financial Diaries with funding from Financial Sector Deepening (FSD) Kenya and the Bill & Melinda Gates Foundation. The ILO’s Impact Insurance Facility provided supplementary funding supporting the analysis on risk management. The project interviewed 300 lower-income households, every two weeks, over the course of a year to capture their complex financial lives. The results on risk management are featured in Paper 39: Two Steps Back: How low-income Kenyans think about and experience risk in their pursuit of prosperity [2].