SOUTHEAST ASIA REVIEW OF ECONOMICS AND BUSINESS
ISSN: 2472-9299 (Print) and 2472-9302(Online) Volume I, Issue 1, 2017, pp. 63-74
http://sareb-journal.org

THE EFFECTS OF COGNITIVE ABILITY ON THE WILLINGNESS OF LOW-INCOME VIETNAMESE FEMALES TO INVEST IN BUSINESS DEVELOPMENT SERVICES TRAINING

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Abstract *Using a survey of over 4,000 female microfinance clients in Vietnam, this study examines the effects of cognitive abilities on willingness of low-income Vietnamese females to invest in business development services (BDS) training. A probit model with sample selection model is used. The paper focuses on three cognitive abilities (numeracy, fluency, and recall), and finds that they all positively affect the willingness to pay for such BDS training. These results have important implications for policies designed to provide BDS training to the poor, and should help shape the business models of microfinance providers. Testing cognitive abilities may help target the most profitable low-income markets.*

Keywords: *microfinance; business development services; human capital investment; cognitive ability; probit model, sample selection.*

I. INTRODUCTION

There is a growing awareness microcredit is an unsustainable way to confront poverty (de Mel, et al, 2008). Therefore, many microfinance institutions have added business development services (BDS) training. A business education program for female micro-entrepreneurs in Peru was found to improve record-keeping (though not profits) (Karlan & Valdivia, 2011). Business training programs have been found to significantly improve business practices, investments, and loan terms (Bruhn & Zia, 2011). Business training has been shown to substantially increase the profits, sales and business knowledge of mostly male entrepreneurs (Berge, et al., 2011; Giné & Mansuri , 2011). The training in these studies was offered to participants free of charge. However, our research suggests that, offering free business development services (BDS) training may not be sustainable for microfinance institutions (MFIs).

For example, a study of four Freedom from Hunger affiliates revealed that the direct cost of providing training related to family, health, nutrition, business development, and self-confidence accounted for 4.7–10 % of MFI's operational costs (Dunford, 2002; Vor der Bruegge, et al., 1999) . In addition, the provision of training and technical assistance may distract MFIs from their credit administration (Berger, 1989). Training services require extra staff recruitment, training, and supervision (Dunford, 2002). Some MFIs will need to cover theses costs via client fees (Sievers & Vandenberg, 2007).

Most studies of MFI BDS training have not focused on the business model sustainability, which depends on clients' willingness to pay. Although investment in education seems an obvious way out of poverty, the poor have been found to avoid such investments (Eckel et al. (forthcoming). The decision to invest in education beyond high school has been shown complex and risky (Chen, 2001). Our study extends a growing literature on BDS training for low-income populations in developing countries (Berge, 2011; Bruhn & Zia, 2011; Giné & Mansuri,

2011; Karlan & Valdivia, 2011; Bulte et al., forthcoming). We study how cognitive abilities influence the female poor's willingness to pay for such training. This study gives policy makers new insights as to what types of consumers are reachable by voluntary BDS training programs.

The rest of the paper is organized as follows. Section 2 presents our research methodology. Section 3 presents the empirical results. Section 4 provides a summary and conclusions.

II. METHODOLOGY

The neoclassical theory of consumers provides our framework for analyzing consumer demand behavior. It is based on utility maximization constrained by budget. We express the net utility gain of investing in BDS training as: $y_j^* = x_j\beta + u_{1j}$, where y_j^* is the net utility gain of investing in BDS training and j is the household index.

Household *j* is willing to pay for BDS training if $y_j^* > 0$. The dependent variable, however, is not always observed. We can only ask clients whether they are willing to pay for BDS training after they indicate interest in training. Thus, the dependent variable for observation *j* is observed if $s_j = (z_j\ \gamma + u_{2j} > 0)$ where $u_1 \sim N(0,1)$, $u_2 \sim N(0,1)$, and $corr(u_1, u_2) = \rho$. s_j is a dummy variable for interest in training. Note that the independent variables do not necessarily need to be the same for the two equations. Following van De Ven & van Praag (1981), we estimate the model of willingness to pay by using the probit model with sample selection. Details of the model are given in Appendix 1. A probit simultaneous equations model regressing the probability of ($y_j = 1$) and ($s_j = 1$) upon covariates is estimated, assuming u_1 and u_2 are standard normal with means and variances equal to 0 and 1 respectively.

We use a probit sample selection model because, when $\rho \neq 0$, standard probit techniques applied to the first equation yield biased results (van De Ven & van Praag, 1981; Vella, 1998). However, the probit sample selection model provides consistent, asymptotically efficient estimates for all parameters in such models. Factors affecting sample selection may simultaneously affect the willingness to pay for training. This is a specification for a binary outcome of the Heckman sample selection model (Heckman, 1979). For the model to be well identified, the selection equation should have at least one variable not in the probit equation. Otherwise, the model is identified only by functional form, and the coefficients have no structural interpretation not in the probit equation.

In summary, the simultaneous probit equations model is specified as following:

$s_j = \alpha + \sum_i^k \gamma_i\, z_{ij} + u_{2j}$, Where, s_j=1 means that microfinance client *j* is interested in the training. s_j=0 shows no interest. z_i measures cognitive abilities, and control variables such as: number of schooling years, age, average household income, and financial difficulties (1=encountered with financial difficulties last 6 months, 0= otherwise).

$y_j = \Omega + \sum_i^k \delta_i\, X_{ij} + u_{1j} > 0, where$ y_j=1 means a microfinance client *j* is willing to pay for BDS training on different price ranges, y_j=0 shows that she is not willing. X_i denotes numeracy, fluency, recall, and control variables such as number of schooling years, financial difficulties, age, average household income and marital status (1= married, 0= otherwise).

2.1. Data Description

Our data was collected in October and November, 2011 as the result of a collaborative project of the University of Groningen in the Netherlands and the TYM fund in Vietnam. The TYM (Tao Yeu May) Fund is a Vietnamese financial institution founded by the Vietnam Women's Union in order to help implement the government's poverty alleviation program. The TYM fund operates mainly in areas with high proportions of low-income households.

We studied information about both the member and the member's household. In addition to the usual set of demographic variables, we studied characteristics such as health, business, farming, saving, insurance, business practices, business knowledge, and domestic violence. The full questionnaire, in Vietnamese and English, is available upon request. For subsequent interviews, we randomly selected 23 out of 30 members per TYM center. In total, we interviewed 4,042 borrowers.

The TYM fund, operating since 1992, is the largest microfinance organization for poor women in North Vietnam. Its mission is to improve the quality of life of poor women and their families by providing them financial and non-financial services. The training provided through TYM is based on the **G**ender and **E**ntrepreneurship **T**ogether Ahead for Women in Enterprise Training, designed by the International Labor Organization (ILO). It was modified to fit the Vietnamese context. As of September 2011, TYM ran operations in ten areas through forty-three branches (for their locations, see Appendix 2). It has established 1,450 loan centers, each serving thirty to forty female clients. The TYM fund offers three main financial products: loans, savings, and mutual assistance funds. Loans require no collateral.

TYM plans to provide a BDS training pilot program in three branches in Vinh Phuc and one branch in Ha Noi. These branches have 187 lending centers with an average of 30 clients per center. They are representative of the low-income population in Vietnam. At the time of our data collection, poverty rates in rural areas in Ha Noi and Vinh Phuc were approximately 11%. In terms of economic and geographical conditions, Vinh Phuc and Ha Noi are representative of the entire country. The government's industrialization strategy has substantially increased the output of the Vietnamese industrial and services sectors. However, Vietnam faces many social problems, including high poverty rates for women.

2.2. Design of the Study

We constructed eight questions to measure cognitive abilities. These were modified from those used in the well-known Survey of Health, Aging, and Retirement in Europe (SHARE) (Christelis et al., 2010; Korniotis and Kumar, 2011; Korniotis and Kumar, 2013). These questions were divided into three categories: numeracy (mathematical skills), fluency (planning and executive skills) and recall (memory). These have been shown relevant for human capital investment decisions (Christelis et al., 2010).

To measure numeracy, clients were asked to perform six simple calculations. From these results, we constructed a numeracy indicator, ranging from one to six. Details on its construction and the questions themselves are given in Appendix 3. Figure 1 reports the sample distribution of numeracy (upper-left graph). The sample average is 4.6, and the standard deviation is 1.2. Approximately 15% of the sample achieved the maximum score, 6. About 60 % scored 5.

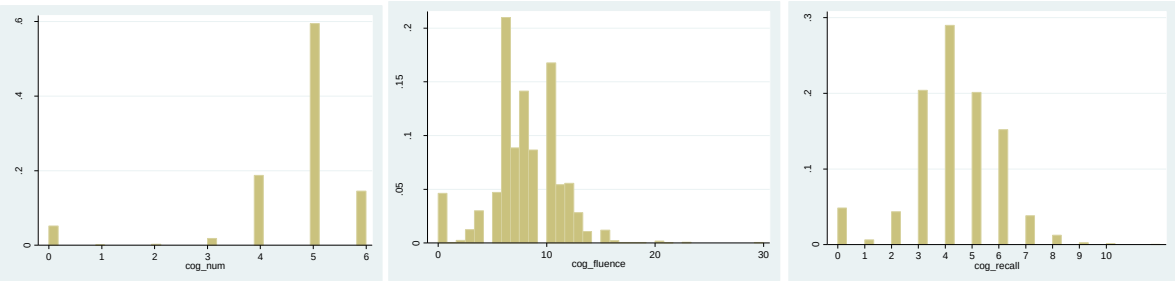

Figure 1. Sample distributions of the indicators of cognitive abilities

Note: Numeracy is constructed on the basis of the number of correct answers to four basic mathematical tests. Fluency is measured as the number of animals that the interviewee can name in 1 minute. Recall is measured as the number of items that the interviewee can recall in a list of 10.

Executive function was measured by asking respondents to name as many animals as they could in thirty seconds. Their scores were the number of animals they named. We call this indicator ''verbal fluency'', or simply fluency. Fluency affects the ability to understand written texts, an important business activity. The distribution of the fluency scores is plotted in Fig. 1 (center graph). The sample average was 7.95, and the standard deviation 3.16. Fifty percent of the sample scored between 6 and 10. Less than 10% scored below 4 or above 15.

To construct the memory (recall) indicator, respondents were first given a list of ten words, and then asked to list the ones they remembered. The sample mean the distribution of the recall indicator was 4.19, and the standard deviation was 1.63. Figure 1 (upper-right graph) shows that approximately 85 % of the sampled scored between 3 and 6, and only 5 % above 6.

Table 1. Demographic and economic characteristics

	Obs	Mean	Std. Dev.	Min	Max
Numeracy	3004	4.65	1.27	0	6
Fluency	4036	7.96	3.16	0	30
Recall	4036	4.19	1.63	0	12
Age	4040	43.77	10.33	19	72
Marital status	4035	0.83	0.38	0	1
Number of schooling years	4029	6.82	2.91	0	18
Average household income	4036	6066.01	3417.32	0	50000
Financial difficulties	4036	0.11	0.31	0	1
Training interest	4036	0.76	0.43	0	1
Willingness to pay	4034	0.07	0.26	0	1

In addition to cognitive ability, our study assumes that willingness to pay also depends on demographics. Thus, our model includes variables for age, marital status, education, household income, and financial difficulties in the previous six months. Sample statistics are reported in Table 1.

In general, the average age among women was 44 years. In addition, approximately 83 % of women were married. They had received on average 6.8 years of education. Households have average monthly income of 6,000,000VND (approximately US$292). Approximately 11% of households reported that they faced financial difficulties last six months. Overall, 76 % of female clients indicated they would be interested in the training if they were invited, but only 7 % were willing to pay for this training.

III. EMPIRICAL RESULTS

Table 2 reports the results of the probit selectivity model, which involved two equations. The results for the outcome equation are in the upper panel. The selection equation results in the lower. Results for the full models including the outcome and selection equations are in column (1). The average marginal effects (AMEs) are in column (2). This measure is preferable to evaluating the marginal effects at the mean (MEM) (Bartus, 2005; Greene, 2003). MEM is the computation of marginal effects at fixed values of the independent variables. The most-often used values are sample means. The AME method is preferred because the sample means used in the MEM method might refer to either nonexistent or nonsensical observations (Bartus, 2005). Before discussing these results further, we discuss the appropriateness of the method of estimation.

The correlation (rho) between the error terms in the selection equation and outcome equation is 0.77. The Wald test of independent equations was significant at the 10% level. This is evidence that rho is not zero, and that sample selection cannot safely be ignored in both specifications. This result confirmed the need for a sample selection model. We randomized the sample at the training center level, but our outcomes are measured at the household level. Thus, we adjusted for cluster effects, and found that most independent variables had higher corrected than uncorrected standard errors.

The results shown in table 2, columns (1) and (2), imply that cognitive abilities are significantly positively related to the willingness to pay for BDS training. For example, if the numeracy score increases by one unit, the probability that a client is willing to pay increases by around 2.2 %. Raising the fluency score by one unit is associated with increase of around 0.5% in the willingness to pay. Finally, raising the recall score by one unit increases the probability of willingness to pay by 0.7 %. Overall, the results support the hypothesis that higher cognitive abilities are associated with the poor's higher willingness to invest in BDS training.

Table 2 reports other interesting results. For example, one year of education added a 0.5 % of probability of willingness to pay. Furthermore, financial limitations were not a big obstacle to willingness to pay. In fact, households with financial problems were willing to pay at a 12 % higher rate. These results are consistent with the information from our 36 focus group discussions (FGDs) conducted in 2012 after the training. Women with financial difficulties were highly appreciative of the BDS training because it has helped them generate income. Moreover, the effect of average household income was significantly negatively correlated to willingness to pay. Raising average household income per month by 1,000,000VND decreased the average probability of willingness to pay by 2.97 %. Therefore, higher income households may have found BDS training not as useful. Most of the high-income households were currently involved in business. They may have found that the opportunity costs of training exceeded its benefits. This argument was confirmed in the FGDs results. Time constraints were one of the most frequent barriers to women's training. Clients living with partners were 2.2 % less willing to pay for training.

Table 2. Willingness to invest in BDS training

VARIABLES	(1)	(2) (Average marginal effects)
Outcome equation		
Numeracy	0.18279**	0.0215***
	(0.030)	(0.0060)
Fluency	0.04246**	0.0050***
	(0.035)	(0.0050)
Recall	0.05813*	0.0068**
	(0.096)	(0.0220)
Number of schooling years	0.04237**	0.0050 ***
	(0.021)	(0.0030)
Financial difficulties	0.68328***	0.1233***
	(0.000)	(0.0000)
Age	0.00184	0.0002
	(0.690)	(0.5920)
Average household income	-0.00003*	-2.97E-06**
	(0.090)	(0.0260)
Marital status	-0.23077*	-0.0229***
	(0.066)	(0.0030)
Constant	-3.20400***	
	(0.000)	
Observations	2,997	2,997
Selection equation		
Numeracy	0.32359***	
	(0.000)	
Fluency	0.04264**	
	(0.014)	
Recall	0.05837*	
	(0.062)	
Number of schooling years	0.00889	
	(0.594)	
Financial difficulties	0.45241***	
	(0.000)	
Age	-0.00410	
	(0.201)	
Average household income	0.00001	
	(0.582)	
Constant	-1.27863***	
	(0.000)	
Observations	2,997	
rho	.7689078	
p. Wald test of independent equation (rho = 0)	0.0522	

Note: Robust p-value in parentheses *** p<0.01, ** p<0.05, * p<0.1

Table 3. Willingness to invest in BDS training without controlling education

	(1)	(2)
VARIABLES		**(Average marginal effects)**
Outcome equation		
Numeracy	0.19104**	0.0225***
	(0.022)	(0.0040)
Fluency	0.04590**	0.0054***
	(0.025)	(0.0030)
Recall	0.06726**	0.0079***
	(0.049)	(0.0070)
Financial difficulties	0.67336***	0.1215***
	(0.000)	(0.0000)
Age	-0.00164	-0.0002
	(0.703)	(0.6060)
Average household income	-0.00002	-2.57e-06**
	(0.141)	(0.0520)
Marital status	-0.23148*	-0.0230***
	(0.065)	(0.0030)
Constant	-2.86707***	
	(0.000)	
Observations	3,002	3,002
Selection equation		
Numeracy	0.32911***	
	(0.000)	
Fluency	0.04357***	
	(0.009)	
Recall	0.05962**	
	(0.048)	
Financial difficulties	0.45419***	
	(0.000)	
Age	-0.00472	

	(1)	(2)
VARIABLES		**(Average marginal effects)**
	(0.144)	
Average household income	0.00001	
	(0.550)	
Constant	-1.23159***	
	(0.000)	
Observations	3,002	
rho	0.8683101	
p. Wald test of independent equation (rho = 0)	0.0157	

Note: Robust p-value in parentheses *** p<0.01, ** p<0.05, * p<0.1

Because cognitive abilities are partly acquired via education (Christeli et al., 2010) , we checked to see what happens when education is omitted from the regression. Table 3 reports that result. Table 3 is organized like table 2. The correlation (rho) between the error terms in the selection equation and outcome equation is estimated 0.88. The Wald test of independent equations (rho = 0) was significant at the 5% level. This is evidence that a sample selection model is superior to a standard probit estimation.

Overall, the effect of all cognitive abilities on the willingness to pay is larger when the model excludes education. Specifically, when numeracy increases by one unit, willingness to pay increases from 2.2 % to 2.3%. Moreover, omitting education also increases the effects of fluency and recall on the willingness to pay from around 0.5% to 5.4 %, and from around 0.7% to 0.8 % when the fluency and recall indicators increase by one respectively. The effects of the other control variables are also slightly higher in the specification without education.

IV. SUMMARY AND CONCLUSIONS

In summary, our research tested the effects of cognitive abilities on the poor's willingness to invest in business development services (BDS) training. Cognitive abilities are fundamental determinants of decision making in economic models (Dohmen, et al., 2010).We focused on three domains of cognitive abilities (numeracy, fluency, and recall), and found they all increased the willingness to pay for BDS training. This result held when controlling for personal characteristics, education, income, and financial constraints. These effects also survived in an additional robustness check.

For the poor, the decision to undertake BDS training and pay for it appears complex. There are many factors involved, including cognitive ability, time available, financial constraints, marital difficulties, and health. These results have important implications for policies designed to provide BDS training to the poor, and should help shape the business models of microfinance providers. Testing cognitive abilities may help target the most appropriate low-income markets.

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APPENDICES

Appendix 1. Probit model with sample selection

The probit model with sample selection (van De Ven and van Praag (1981))assumes that there exists an underlying relationship $y_j^*=x_j\beta + u_{1j}$ latent equation

Such that we observe only the binary outcome

$y_j^{probit} = (y_j^* > 0)$ probit equation

The dependent variable, however, is not always observed. Rather, the dependent variable for observation *j* is observed if

$$y_j^{select} = (z_j \gamma + u_{2j} > 0)$$

Where $u_1 \sim N(0,1)$

$$corr(u_1, u_2) = \rho$$

The log likelihood is

$$\ln L = \sum_{\substack{j\in S \\ y_j\neq 0}} w_j \ln\left\{\Phi_2\left(x_j\beta + offset_j^{\beta}, z_j\gamma + offset_j^{\gamma}, \rho\right)\right\}$$

$$+ \sum_{\substack{j\in S \\ y_j=0}} w_j \ln\left\{\Phi_2\left(-x_j\beta + offset_j^{\beta}, z_j\gamma + offset_j^{\gamma}, -\rho\right)\right\}$$

$$+ \sum_{j\ni S} w_j \ln\left\{1-\Phi\left(z_j\gamma + offset_j^{\gamma}\right)\right\}$$

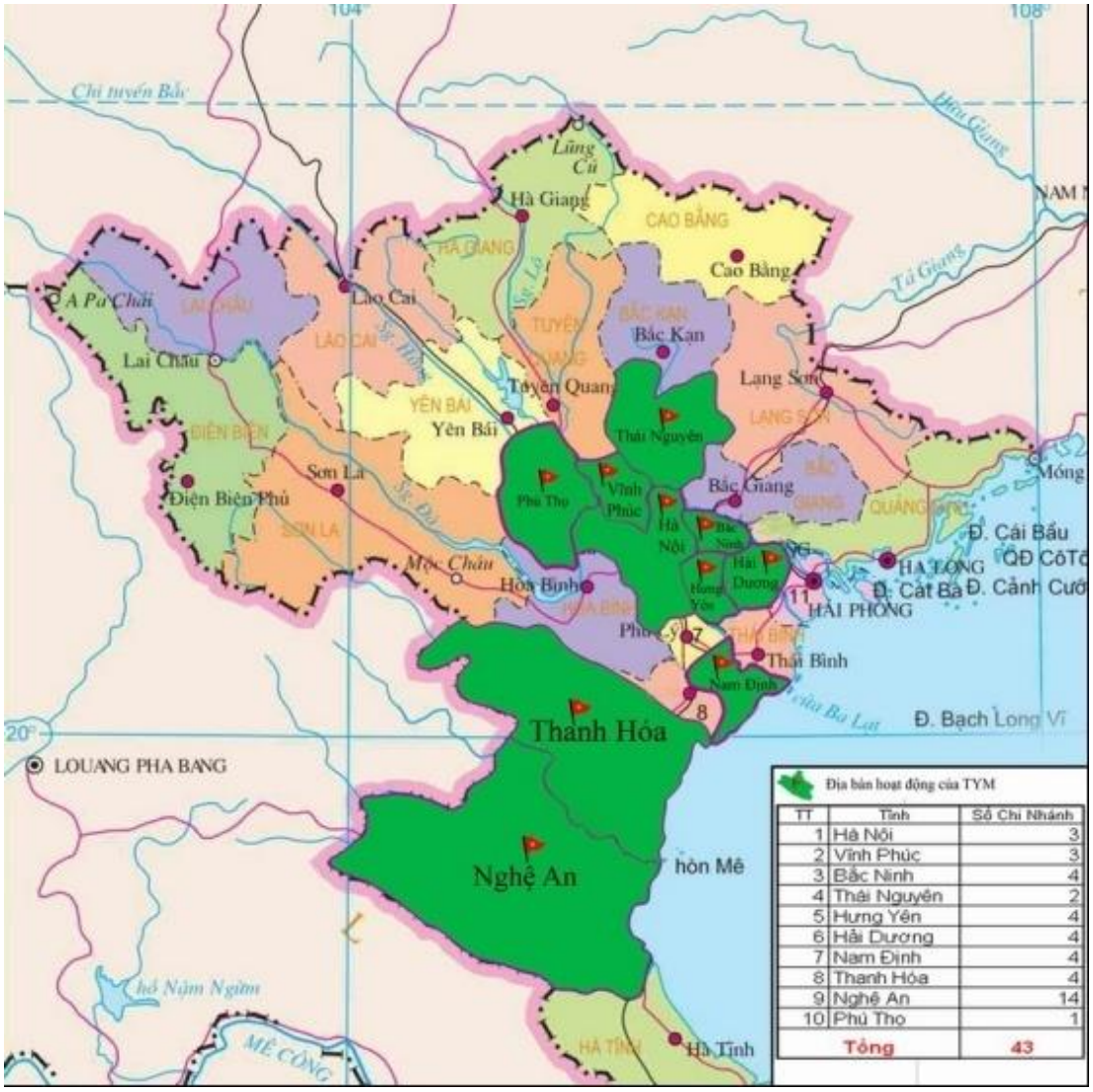
Where S is the set of observation for which y_j is observed, $\Phi_2(.)$ Is the cumulative bivariate normal distribution function (with mean $[0\ 0]'$), $\Phi(.)$ Is the standard cumulative normal, and w_j is an optional weight for observation j

In the maximum likelihood estimation, ρ is not directly estimated. Directly estimated is atanh ρ:

$$\operatorname{atanh}\rho = \frac{1}{2}\ln\left(\frac{1+\rho}{1-\rho}\right)$$

From the form of the likelihood, it is clear that if $\rho = 0$, the log likelihood for the probit model with sample selection is equal to the sum of the probit model for the outcome *y* and the selection model. We can perform a likelihood-ratio test by comparing the likelihood of the full model with the sum of the log likelihoods for the probit and selection models

Appendix 2. Map of TYM's Operating Areas



TT	Tỉnh	Số Chi Nhánh
1	Hà Nội	3
2	Vĩnh Phúc	3
3	Bắc Ninh	4
4	Thái Nguyên	2
5	Hưng Yên	4
6	Hải Dương	4
7	Nam Định	4
8	Thanh Hóa	4
9	Nghệ An	14
10	Phú Thọ	1
Tổng		43

Appendix 3. Questions for cognitive ability measures

Numeracy
1. What is 400 plus 300?
2. What is one tenth of 100?
3. In a sale, a shop is selling all items at half price. Before the sale a TV costs 4,000,000VND. How much will it cost in the sale?
4. If you sold two items for 8,000 VND each and your customer gave you 20,000 VND, how much balance do you owe the customer?
5. Suppose you had 1,000,000VND in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?
1. = More than 1,100,000VND
2. = Exactly 1,100,000 VND
3. = Less than 1,100,000 VND
KB = Do not know.
6. Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account?
1. = More than today
2. = Exactly the same
3. = Less than today
KB = Do not know.
7. **Fluency**: I would like you to name as many different animals as you can think of. You have 30 seconds to do this.
(*Record number of correct animals)*
8. **Recall:** I will read out a list of items. After I read, please recall the items I mentioned?
The list includes the following items: Electricity, Arm, Letter, King, Ticket, Grass, Rice, Brick, Book, Corn *(Record number of items recalled)*