Determinants of personal Financial literacy

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Abstract

This paper attempt to posit about financial literacy as whole and which factor have been affected to determine level of financial literacy. The objectives of this study are to identify the determinants of personal financial literacy and to suggest what strategies are needed to increase the personal financial literacy. Secondary data and primary data have been used for this. According to previous studies about financial literacy some factors such as Age, Gender, Household income, education, money management, spending habit, work experience, are effected to determine level of personal financial literacy. Therefore this factors can be identify as main factors effected on financial literacy. This paper suggested that needs develop national financial education frameworks collaboration of parents, educators, financial institutions and policy makers to improve personal financial literacy.

Introduction

Financial literacy is a main component of economic development. It has become an important concepts in the modern economy. The modern economy is a globalization economy. There is a genuine relationship with financialization. Therefore all countries and nations can be deal with each other easily. Having good knowledge about financial concepts is essential to deal with each other in the present economy. Hence discussing about financial literacy is a valuable thing as topically.

Current economic conditions have raised serious concerns about financial s, especially for those who lack the skills and resources to withstand financial market downswings and take advantage of upswings. Individuals are taking responsibility for a growing number of financial decisions, the two most important arguably being the purchase and financing of a home and preparing

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for retirement. As these choices have been became more complex. First, poor financial decision making may be a surprisingly widespread phenomenon. Second, such problems may build unnoticed for a long time before a crisis is reached. Third, the systemic effects and the costs of preserving stability may be sizable, as demonstrated by the ensuing financial market turmoil and subsequent interventions. Poor savings and investment decisions may be less visible, but carry serious implications for long-term financial security for major parts of population. According to empirical studies about financial literacy, pension plans and uncertainty about government Social Security, households are being increasingly called upon to undertake their own financial planning for retirement. Money Research in behavioural finance suggests that many households do not in fact make optimal savings and investment decisions, and the realization that these choices may well lead to unacceptable standards of living has also increased economic disorderliness.

Therefore concepts of literacy, concept of finance, definition of financial literacy, benefit of financial literacy, factors effected on financial literacy and finally conclusion and suggestions have been posited by this paper.

Concept of literacy

It is important to know about concept of literacy before discussion about financial literacy. Before that, understanding about meaning of the word “literacy” is necessary.

The word “literacy” has been derived from the word of “literate” in 1886. “Literate” has been derived from the word of “literae”. Literae is a Latin word which means that “literature” or “letters” (Mckenzie, 2009). Oxford dictionary defines literacy as “ability to read and write” and also Cambridge English dictionary defines as “the ability to read and write”. According to the Dictionary com literacy is “the quality or state of being literate, specially the ability to read and write”.

According to this definition, generally literacy can be identified as “ability to read and write”. There are few type of literacy in the concept of literacy such as educational literacy, computer literacy and financial literacy. Thereby financial literacy can be identified as exclusively.

Concept of Finance

Merriam-Webster defines finance as "the way in which money is used and handled; the way in which large amounts of money are used and handled by governments and companies". According to definition of Oxford dictionary finance "the management of large amounts of money, especially by governments or large companies". Cambridge dictionary defines financial or monetary as "relating to money or how money is managed".

However the concept of financial/monetary was developed because of becoming the money as the main exchange method in the economy. Before the evolution of money as the main exchange method, exchange was done via "BARTER SYSTEM". In the Barter system, a one good exchanged directly to another good. Barter economy is a moneyless economy and also it is a simple economy. In this economy, People produced goods either consumption or exchange with another good. But as a method of exchange, there was some difficulties and disadvantages in the barter system as follow (Jhingan, 1994); Lack of double coincidence of wants, Lack of common measure of value, Indivisibility of certain goods, Difficulty in storing value, Difficulty in making deferred payments.

Because of this difficulties "money" became a main exchange method in the economy. In the present global economy, money have been became a kingpin. Money have been defined in different ways.

Money are defined by professor coulborn as "the means of valuation and payment; as both the unit of account and the generally acceptable medium of exchange". According to Scitovsky " Money is a difficult concept to define, partly because it fulfil not one but three functions, each of them providing a criterion of moneyness…those of a unit of account, a medium of exchange and a store of value" (Jhingan, 1994).

However money is an essential thing in day to day life. The modern economy is an exchange economy. That way, people satisfy their needs involving a production process and exchanging income which they get from their production process with goods in the market. Therefore the modern economy defines as a money economy (Fernando, 2000).

There are some features in money as; general acceptability, stability of value, profitability, divisibility, durability, storability and also communicability. Therefore money play an important role in economy. Hence we cannot discuss about finance or financial literacy without the money. Concept of financial/monetary is occurred after money became as the main exchange system in the economy.

Financial Literacy

Various definition have been presented about financial literacy. Normally financial literacy can be defines as the ability understand about financial concepts.

The organisation for Economic Cooperation and Development- INF (2011) defines financial literacy as “A combination of awareness, knowledge, skill, attitudes, behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing”.

According to ANZ (2011), five components such as planning ahead, choosing financial products, studding informed and financial control are consisted in financial literacy.

Aggarwal (2014) have said that “Financial literacy enable individuals to navigate financial world, make informed decisions about their money and minimise their chances being misled on financial matter”. Furthermore financial literacy has been became at significant level because of few things such as the importance of having a financial literacy in financial market, becoming Credits as most significant things in the market share, rapidly developing and marketing of financial products and encouragement of government for people to take more responsibility for their retirement income. According to Aggarwal it is important to having a financial literacy in the financial market.

OCED (2005) concerning financial education, they define financial education as “The process by which financial consumers/investors improve their understanding of financial products and concepts and through information instruction and/or objective advice, develop the skills and opportunities, to make informed choices, to know where to go for help and to take other effective actions to improve their financial well-being”. Hence financial education is an essential thing for financial literacy and it affect to the humans' well-being. According to that anyone can not consider about financial literacy without financial education.

According to president annual report in USA, financial literacy is a thing more than balancing the check book, comparing price and ability to getting a job. It is a vision and plan for a long time. As well using skill in every day for the future, relevant to the financial literacy. Financial literacy relevant to persons' life time. In production side financial literacy need to evaluate the production and making decisions and also in consumption side to start a bank account, mortgage jewellery and getting money and in both regular and unregularly financial transaction is needed financial literacy.

Financial literacy defines by Criddle (2006) as "financial literacy is not just about the mechanics of checking bank accounts, or even budgeting for future savings. The definition can be expanded to include learning about selecting between a multiplicity of choices, setting personal financial goals, and reflecting on values about money" (ASIC, 2011).

According to Hira and loibl (2005) financial literacy is a main element of financial education. Servon and kastner (2008) defines financial literacy as the persons' ability to understand and use the common financial concepts (Central Bank, 2014).

In the present economy, people betide to involve in various works to achieve their own needs. And also they have to make various decision. Therefore People must have some knowledge about financial production and financial institute to earn money as well to spend. Hence financial literacy defines as the persons' knowledge under the general money handling to make that decisions (Central Bank, 2014).

Asian development bank defines financial literacy as "the ability of an individual to understand financial terms and concepts and to translate that knowledge skilfully into behaviour" (Fernando, 2010). Financial literacy defines an Indian scholar as "essentially knowledge of good money management practices, encompassing all monetary transaction that a person enters into such as earning, spending, saving, borrowing and investing" (Fernando, 2010).

Pathmanathan (2012) defines financial literacy as “the knowledge of basic financial concepts, principles, skills and attitudes whose application leads to behaviour that improve financial outcome”. Furthermore he mentions that improved financial knowledge, skills and attitudes affect to change the financial behaviour (Bank of Ceylon, 2012).

Normally financial literacy can be refer as the persons’ ability to understand basic concepts of finance. The basic aspirations such as compounding of interest, trade-offs between risk and return, effect of inflation and diversification are included in this (Bank of Ceylon, 2012).

Benefit of financial literacy

There are lot of benefit of financial literacy. Researches has posited that financial literacy is beneficial for individuals and families (Blalock et al., 2004; Danes & Hira, 1987; Hibbert & Beutler, 2001; Kerkmann, Lee, Lown, & Allgood, 2000). Financial literacy increases students’ chances for saving and investing, getting out of debt, spending less than they earn, and living on a budget. It also decreases their chances for bankruptcy, receiving government assistance (Bauer et al., 2000; Blalock et al, 2004; Huston et al., 2003), and making poor consumer decisions (Grable & Joo, 1998; Hayhoe, Leach, Turner, Bruin, & Lawrence, 2000). Students who lack financial knowledge have increased financial difficulties that continue into later years (Danes & Hira, 1987; Hibbert & Beutler, 2001; Hira, 2002).

Chen and Volpe (1998) found that students with less financial knowledge had more negative opinions about finances and made more incorrect financial decisions. They point out that having a low level of financial knowledge limits students’ ability to make informed decisions. Danes and Hira related students’ financial behaviour about their future earning capacity. Danes (1994) mentioned that a higher level of financial knowledge was positively correlated to a higher level and regular source of income as well as a higher savings rate. The financial habits students have while in college tend to carry on into adult life. The better their financial literacy is when they leave college, the fewer financial hardships they may have in life (Grable & Joo, 1998).

The Factors effect on financial literacy

According to empirical studies about personal financial literacy, few factors have been identify effected on personal financial literacy

Gender and financial literacy

Gender can be identified as a main factors among the other factors which effect on personal financial literacy. Many studies about financial literacy have been considered gender as an effective factors on financial literacy vice versa.

According to Almenberg and save-soderberg (2011) there is a large inequality in financial literacy between male and female in Sweden. Less participating to decision making on economic problems is indicated as reason for that. A study about money management knowledge of college students has been done by Danes and Hira in 1987. In this study they conclude that males have more knowledge about personal loans and insurance than females. Conversely females have more knowledge about issues on knowledge of financial management. A study which has been done by Stănculescu (2010) exhibit that financial literacy of females less than males. And also he posit reason for that. Considering about general knowledge, females has gotten 7% marks and males has gotten 15%. Therefore Stănculescu less general knowledge is identified as a main factor impact on women's financial literacy. When consider about savings and lending, females and males have gotten marks as respectively 6% and 7%. As well as 5% of females and 8% of males have a knowledge on insurances. There is not a significant difference between males and females on investment knowledge. Males and females have categorised depend on level of marks which they get. Considering average mark level, there is a difference between male and females by 10%.

Manton (2006) has done a research what college freshmen admit to not knowing about personal finance. The females react for questions as "Don't know" selecting the wrong answers for thirteen questions of the 20 questions than male's reacting. Ibrahim, Harun and Isa (2009) have surveyed financial knowledge, financial attitudes and family influence based on gender, semester and programmes. This study was founded that there were no any differences in financial knowledge, financial attitudes and family influence based on gender. Although they were found a difference in financial attitudes based on gender. Therefore it can be identified that gender effect for the personal financial attitudes.

Volpe, Chen and pavlicko (1996) have examined about high school students focusing on knowledge of investment. In this study they found that “male students are more knowledgeable than female students”. According to Goldsmith’s (1997) study which “sex deference in financial knowledge”, women have failed in their assessment test than male. Likewise women were not most interested in investment and personal finance issues. Kent (2010) exhibit when considering market and investment women’s knowledge is low than men and men have an awareness about financial market and investment than women. As they pointed out by Beal and Delpachitra male have higher financial knowledge than female

Education and financial literacy

A research has conducted about financial literacy by young, see and Baronovich, 2012 in Malaysia. In this study they have considered relationship among financial literacy and retirement planning and either retiree can achieve a beneficial financial planning for retirement via improving education level.

According to Schagen and Lines (1996) students in higher education and not living at home is a one of the groups relevant to persons who have difficulties with debt and least confident in dealing with financial affairs. Bernheim, Garrett, and Maki (2001) exhibit that middle-age persons who involve in a personal financial management course tended to save a higher amount of their income than other persons who have not involve in a personal management course. The results of this research indicate that lot of persons could not remember they had taken a course in money management or personal finance or did not. However Bernheim, Garrett, and Maki’s (2001) point of view financial education impact on savings positively.

Johnson and sherraden (2007) point out that basic financial skills of high school are law and they do not discuss financial matters. According to Lusardi and Mitchell (2006, 2008) University students is well-informed persons than less educated students. As posit by Beal and Delpachitra (2003) Students who studying business, have higher general financial knowledge and skills.

Furthermore as delpachitra's point of view student's faculty which study are effected to students' financial literacy. In their study they have concluded university students have not skill and knowledge in financial matters and it is tend to impact negatively on their future live. They suggest that this problem can be solve by focusing on education, evaluation and monitoring of national education programs and others. Chen and volpe (1996, 1998) also have founded that business major students are more knowledgeable than non-business majors. Aggarwal (2014) have founded that the level of education and discipline effect to the financial literacy of youths. According to Aggarwal pointed out that need to teach personal financial knowledge at an early age. The study is suggested that needs develop a national financial education framework collaboration of parents, educators, financial institutions and policy makers.

Work experience and financial literacy

Delpachitra (2003) the factors such as Gender, work experience, income, type of faculty which study are effected to students' financial literacy. If someone have greater work experience, higher income and lower aggregate risk preference he/she has a higher financial literacy than others. Professionals, executives, business owners can be said to demonstrate higher level of financial literacy than unemployed and non-working. Monticone (2010) notes that, in Italy, white-collars, managers and self-employed are the most literate population groups. The study about financial literacy of Ukrainian peoples which done by Olga (2011) is exhibited that least level of financial literacy predicted by employers and retirees. Employers who have higher level of education and specialized demonstrate higher level of financial literacy. Additionally, qualified employers is more literate in finance than unqualified employers. Entrepreneurs, employers and government employers have high level of financial literacy. Job and working experiences are important factors effect on persons' financial literacy. According to chen and volpe less work experience course to decrease personal financial literacy. Middle-age person who with high level of work experience have financial literacy (Chen and Volpe, 1998).

Money management

Money management is an important component of adults' life because of Students' spending habit in university is influence on their money management (Ibrahim et al, 2009). Less money management skills course to lack of financial knowledge in Kedah campus. 32 percent of college students are distrust about their ability of managing money in campus. Therefore money management can be consider as independent variable which effect on level of financial literacy (Ibrahim et al, 2009). According to Roy's view (2003) financial literacy of peoples is relevant to informed and decision making include the spending habit. Young generations spend their income instantly on consumption goods and they omit their long term personal finance (Greenberger and Steinberg, 1986).

Davidson (2006) exhibit educated students normally spend income on reading, education, housing, food, clothing and cyber café etc. Therefore Davidson point out that it is essential improving financial literacy of students who have lot of spending. Trainings which relevant to the financial literacy must be conducted by high school and universities. Students who have higher level of financial literacy make useful decision about spending (chen and volpe, 1998). Students are knowledgeable using of credit cards. Student's knowledge decrease if interest charges and using problem of credit cards are arise. Students have awareness about medical insurance but they have not an awareness about income insurance, life insurance, provisions of auto insurance and the rate of return of cash value is low. Students present a high level of knowledge relevant to importance of record keeping (Danes and Hira, 1987).

Household income and financial literacy

People who receive a low level of income are weaken on money management. Therefore they always have to face to financial difficulties. Low income people are not making intelligent decision about their personal savings, do not planning ahead and fail in choosing finance products are reasons for that (Stănculescu, 2010). According to Mendel (2010) personal income and household income are effected on students' financial literacy. The relationship between financial literacy and household income is an inverted relationship. Students who receive high level of household income show a law level of financial literacy than middle class students. Hence personal income and household income, as well involving to process of money management in the household are affected on personal financial literacy. Students who receive a middle level of household income participate for financial issues. It course to high level of financial literacy of them. According to this personal income, household income and contribution for management process of expenditure and income are affected on level of financial literacy (Mendel, 2010).

Volpe (2002) have done a study about entrepreneurs who deal with online. This study have been used 5030 entrepreneurs. According to volpe there is a relationship between financial literacy and level of personal annual income. Using annual income, people have categorized to group as less than US $ 20000, between US $ 40000 – 74999 and more than 75000. Thereby people who less than US $ 40000 have been categorized as people with low level of financial literacy than others.

Conclusion

According to this definitions financial literacy can be define as “A combination of awareness, knowledge, skill and attitudes, education, decisions making, behaviour and planning about finance. Simply financial literacy can be identified as persons’ ability to understand financial concepts. There are lot of benefit of financial literacy. Financial literacy is a main component of economic development. People should have knowledge about financial literacy, because they have to deal with complex financial markets. Financial education, household income of person, situation of the household, work experience, money management, spending habit, age gender are effected to determine level of personal financial literacy. If people have a good financial knowledge and education, good work experience and person and person has high level of household income, good money management skills, good expending habit have high level of financial literacy.

Therefore this paper is suggested that needs develop national financial education frameworks collaboration of parents, educators, financial institutions and policy makers to improve personal financial literacy.

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