

# Financial Literacy

**Dr. Pratima**

Assistant Professor, Department of Commerce, DPG Degree College, Gurugram

## ABSTRACT

Financial literacy has been recognized as a key skill for individuals who are embedded in an increasingly complex financial scenario. Financial literacy helps individuals make more assertive and efficient decisions in the monetary context of their lives. This paper measures the level of financial literacy of individuals and analyses the relationship between financial literacy and financial behaviour. The results of the research show that individuals have a reasonable level of financial literacy. On analysing financial behaviour of individuals it was found most of them exhibited moderately positive financial behaviour.

**Key words:** basic financial literacy, advanced financial literacy.

## INTRODUCTION

**“Money is one form of power. But what is more powerful is financial education” - Robert Kiyosaki**

Financial Literacy is the ability to understand how money works in the world and take an informed as well as a judicious decision with regard to all financial activities. A person who is financially literate knows how to earn, manage and invest money. He is familiar with financial products and applies his knowledge to make the best use of them. Recent developments have made financial education and awareness increasingly important for financial wellbeing.

The information available on consumer financial literacy shows that individuals generally lack an adequate financial background or understanding to navigate today's complex market, but unfortunately they also generally believe that they are far more financially literate than is really the case. The level of financial literacy tends to vary according to education and income levels, but the evidence shows that highly educated consumers with high incomes can be just as ignorant about financial issues as less educated, lower income consumers. The objective of this paper is to attempt to understand the level of financial literacy of individuals. The relationship between financial literacy and financial behaviour is also studied.

## REVIEW OF LITERATURE

**Studies by the OECD and Lusardi and Mitchell** reviewed international evidence on financial literacy and found that financial illiteracy is common in many developed countries such as Australia, Japan, and Korea, as well as developed countries in Europe. These findings are similar to those of Christelis, Jappelli, and Padula who found that most respondents in Europe score low on financial literacy scales. Financial Literacy and Behaviour Several studies showed that financial literacy is positively related to self-beneficial financial behaviour. Hilgert, Hogarth, and Beverly added financial behaviour and financial literacy questions to the nationwide Survey of Consumer Finances. They formed a Financial Practices Index based upon behaviour in four variables: cash-flow management, credit management, savings, and investment practices.

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**Maarten van Rooij, Annamaria Lusardi, Rob Alessie:** To understand financial literacy and its relation to financial decision making it is essential to measure numeracy and basic knowledge related to the working of inflation and interest rates as well as to measure advanced financial knowledge related to financial market instruments like stocks, bonds and mutual funds. The study showed that those who have low financial literacy are significantly less likely to invest in stocks.

## **OBJECTIVES**

The main objectives of the paper are as follows:

1. To measure the level of financial literacy. This is done by measuring both basic and advanced financial literacy.
2. To measure financial behavior.

## **DATA AND METHODOLOGY**

For the purpose of the study convenience sampling was followed and 100 responses were collected. The study uses questionnaire method of data collection. The questionnaire consisted of three parts: the first part covers demographic information, the second part aims at measuring the level of financial literacy and the third part aims to analyze the financial behavior of the respondents. Cronbach's alpha test was administered to assess the reliability of the questionnaire. The result of the reliability coefficient (alpha) was 0.730.

## **ANALYSIS AND RESULTS**

### **Overall literacy**

To test the level of literacy of the respondents, 20 questions were asked to assess their knowledge on various concepts like simple interest, compounding, time value of money, inflation, credit purchase, savings interest, diversification, stock markets, bonds, debentures, mutual funds and loan financing. For each of the questions three options (Yes / No / Don't know) were given to the respondents. The answers given by the respondents were evaluated for each of the questions and categorized into 'correct answers', 'incorrect answers' and 'don't know'

An item wise analysis was conducted for each of the questions on knowledge. More than 80% of the respondents were well aware about the concept of simple interest, inflation, stock price fluctuations, credit cards and savings account interest as they have answered the questions on the above concepts correctly. The respondents had a reasonably good score of for concepts such as stock market functions, mutual fund, stock & bond risk factors, diversification and loan financing by answering them correctly. It is observed that most don't have knowledge about bond / debenture prices and credit purchasing power.

To obtain an overall score on financial literacy for each respondent, the 'correct' answers given by the respondents for each of the question is considered. It can be summarized that the overall mean score of the respondents for 'correct' answer was 14.43 and SD was 4.02. The minimum score was 2 and maximum was 20. It is found that 64% of the respondents have a fairly reasonable overall financial literacy score as they have answered more than two thirds of the questions correctly. 3% of the respondents have answered less than one third of the questions correctly and have a low overall financial literacy and 33% of the respondents have moderate financial literacy as they have answered 7 to 13 questions correctly.

For a deeper analysis the questions were categorized into two groups (basic literacy and advanced literacy). The first group consists of questions which capture people's capacity to handle basic financial literacy concepts such as simple interest, compounding, time value of money, inflation, credit purchase and savings interest. The second group is intended to capture sophisticated or advanced financial literacy concepts such as risk / return, difference between stocks and bonds, functioning of the stock market, relationship between bond prices and interest rates, working of mutual funds, risk diversification and loan financing.

### **Basic literacy**

The mean score of the respondents for basic literacy was 5.97 and SD was 1.50. 75% of the respondents have a score higher than the mean value. This shows that majority of the respondents are well aware of basic literacy concepts. Further the respondents were grouped into three categories – those with low, moderate and high level of knowledge. It is observed that 68% of the respondents fall into the 'high' category and have answered 6 or more questions correctly from a total of 8. 31% of the respondents fall in the moderate segment by having given 3 to 5 correct answers and just 1% of the respondents fall in the low basic literacy segment with a maximum score of just 2 correct answers. With respect to individual questions on basic literacy more than 80% of the people have got questions on simple interest, inflation, credit cards and savings interest rate correct. However only 44% were aware of the concept of how credit purchase affects purchasing power. 60% to 70% of them were well informed about time value of money.

### **Advanced literacy**

Mean score of the respondents for advanced literacy is 8.46 with a SD of 2.95. Questions on stock markets, bonds, debentures, mutual funds, diversification and loan financing were asked to test the level of advanced literacy among respondents.

A similar analysis as that of basic literacy was performed and the scores of the respondents in this group were also categorized into low, moderate and high level. The results show that 58% of the respondents fall into the high category and have answered 9 or more out of 12 questions correctly. 29% of the respondents are in the moderate literacy level by giving between 5 to 8 correct answers. 13% of the respondents belong to the low advanced literacy segment.

In the advanced literacy segment for 7 out of 12 questions more than 75% of the respondents gave correct answers. A large number of respondents were not aware of bond prices as only 35% gave the ‘correct’ answer. For the question on comparison between stocks & bonds and stocks & mutual funds, number of respondents who opted ‘don’t know’ is higher than those who gave the wrong answer.

## FINANCIAL BEHAVIOUR

In this section a set of 22 questions on a 5 point scale is used to study the financial behaviour of the individual. A It is found that 25% of the respondents have low or negative financial behaviour, 48.2% of the respondents show moderately positive financial behaviour and 26.8% of them exhibit highly desirable behaviour.

Behaviour Factors	Mean	SD
Debt management	19.23	4.70
Personal financial management	22.63	4.61
Long term planning	24.07	7.04
Emergency and risk planning	10.92	2.87
Advice seeking	10.49	2.69
Overall behavior	87.33	19.16

**Debt Management:** It considers dimensions such as payment of bills like rent, insurance premium, electricity, credit card etc. Short term loans taken in the past few years and repayment of loan on time is also taken into account while evaluating debt management.

**Personal financial management:** It considers dimensions such as drafting a monthly budget, buying things after careful consideration and identifying needs and wants separately.

**Long term planning:** It considers dimensions such as retirement planning, long term saving and long term investments.

**Emergency and risk planning:** To exhibit positive financial behaviour one needs to set aside emergency fund and be adequately covered by insurance. This factor analyses emergency and risk planning behaviour of the respondents.

**Advice seeking:** It is considered important to be updated on financial information from various sources like newspapers, TV, friends and financial consultants. This factor studies the financial behaviour of the respondents with respect to advice seeking.

### Financial literacy and financial behaviour

This section aims to study the relationship between the level of literacy (knowledge) and financial behaviour. Pearson’s correlation test is used to determine the relationship between the basic literacy, advanced literacy, overall literacy and financial behaviour. The results show that the correlation coefficient between overall literacy and overall financial behaviour is 0.717 which indicates 71.7% positive relationship between overall literacy and overall behaviour and this is significant at 1% level. The correlation coefficient between advanced literacy and behaviour indicates 66.6% positive relationship between the two variables and correlation between basic literacy score and behaviour is 67.9% positive at 1% level. It is clear from the above analysis that the level of literacy has a positive relationship with financial behaviour.

## CORRELATION

	Debt Management	Personal Finance	Long Term Planning	Emergency and Risk	Advice Seeking	Overall Behaviour
Basic Knowledge	.661(**)	.629(**)	.556(**)	.575(**)	.533(**)	.679(**)
Advanced Knowledge	.670(**)	.588(**)	.547(**)	.565(**)	.529(**)	.666(**)
Overall Knowledge	.712(**)	.646(**)	.588(**)	.608(**)	.567(**)	.717(**)

\*\* Correlation is significant at the 0.01 level (2-tailed).

## MULTIPLE REGRESSION ANALYSIS

Variables	Unstandardized Coefficients	SE of B	Standardized Coefficients	t	Sig.
(Constant)	10.137	1.319		8.529	.000
Basic Literacy	.312	.261	.387	1.964	.030
Advanced Literacy	.493	.132	.422	3.726	.000

Dependent Variable: Financial Behaviour

These results are further validated by performing a regression analysis. The dependent variable is financial behaviour and the independent variables are basic and advanced literacy. Based on the standardized coefficient it can be inferred that advanced literacy (0.422) is the most important factor influencing wellbeing followed by basic literacy (0.387)

## CONCLUSION AND DISCUSSION

This paper attempts to evaluate the level of financial literacy (knowledge) and bring out its impact on financial wellbeing.

The major findings of this study are that most of the respondents (64%) have a reasonable level of financial literacy. This is a positive sign. It is found that 80% of the respondents are well aware of basic literacy concepts such as simple interest, inflation, credit cards and savings interest rate. Only 56% of the respondents are well aware of advanced literacy concepts such as long period returns, stock price fluctuations, risk / return on stocks / bonds and diversification. Respondents are quite unaware with basic financial concept such as compounding, time value of money and credit purchase and advanced financial concepts such as functioning of the stock market, bond prices, mutual fund and loan financing. Majority of the respondents have a moderately positive behaviour. In dimensions such as debt management, personal finance, long term planning, emergency & risk and advice seeking behaviour positive financial behaviour is observed.

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