

## Determinants of Financial Literacy And Its Measures

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### **Abstract:**

*Financial literacy and the need for financial knowledge have been attracting attention due to their role in the financial situation. Financial literacy is a way of understanding financial concepts and procedures and applying this awareness to solve financial impediments. Financial literacy is fundamental knowledge about the finance environment in order to thrive in modern life. Higher financial literacy results in informed financial decisions relating to retirement and saving. Financial knowledge is decreasing at all levels due to a lack of financial education. Almost all demographic and socioeconomic variables have a significant impact on financial literacy. A universally accepted financial literacy measurement hasn't been adopted, as different methods have been employed by various scholars, such as performance tests, self-report tests, objective tests, and self-assessment tests. Financial behavior and financial attitudes are considered components of financial literacy but not as part of the measurement. To enhance financial literacy, training should be offered on how to manage one's own finances, favorable methods of financial education should be provided, the main determinants should be identified, and financial behavior and financial attitudes should be considered as measurements rather than components. Therefore, this paper reviews determinants and measurements of financial literacy.*

**Key words:** financial literacy; measurement; Determinant and Financial decision

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### **1. Introduction**

#### **1.1. Background and justification**



Financial literacy is a key and has significant impact in economic and financial conditions and allow the people in explaining various economic and financial behavior. Financial awareness is one of a key agenda both for developed and developing countries due to its role in financial situation. For this reason, the United States government in January PACFL(2008), has established a President's Advisory Council on Financial Literacy aiming to make better financial literacy at all parts of the economy. Schwab et al.,(2008) suggested that some Developing countries like Ghana and Indonesia had set up programs that are played a key role in improving financial literacy.

Financial literacy is indispensable but its awareness low across the world. Lack of financial skill or knowledge is widespread both for developing and developed nations (Nalini, 2011; Xu and Zia., 2012). To avoid such challenge financial education is the main remedy. According to some studies, for instance, (Lusardi and Mitchell, 2013; Socol, 2014), indicated that the involvement of financial literacy is critical. The study conducted by Xu and Zia (2012) about financial literacy across the world also highlighting lack of supporting facts from developing country on level of financial literacy and they confirmed that financial education involvements regardless of financial literacy is equally important for all nations in developed and developing countries. From this empirical evidence financial knowledge /skill/ has same significance for the people across the globe. Financial literacy has various benefits. Some scholars mentioned more on its benefits. According to Behrman et al.,(2012) and Lusardi & Mitchell (2014), People who have enough financial skills can do healthier job forecasting and saving for retirement.

Financial literacy a turn key in the developing economy. it is also the most important for the households and business men. good level of financial knowledge can help you thrive in any area of business, and uplift your decision-making, negotiation, and leadership skills. Low financial literacy leads to poor financial decision and poor living standards. individuals with low financial knowledge will face sophisticated challenge relating to bankruptcy and higher debt rates and more likely to make poor borrowing decision. Number of studies has been conducted across the globe due to its importance for all nation. According to Xu and Zia (2012), financial literacy affects all level of the societies irrespective of low-middle, high-middle income countries. Thus, this paper would try to review financial literacy situations and provide recommendation for better solution.

## 1.2. Objectives

The overall objective of this review study was to review Financial Literacy Situation; determinants and measurements, and it specifically aims to:

-  Review the determinants of Financial Literacy
-  Review measurements of Financial Literacy

## 2. Methodology

This review is based on an intensive literature review of published and unpublished materials like books, articles, and other scholarly materials. The data are presented in a narration form.

## 3. Review of the literature

### 3.1. Definition and Concepts of Financial Literacy

Financial literacy has been defined in many ways by different researchers and they have used different connotation depending on nature and objectives of studies. Nearly all definitions have alike components. All refer to the significance of having more skills and knowledge needed to make well-versed decision in such uncontrollable environment. The main basic definition seems to be the knowledge about how to use the money and understanding of the significance of the money. It provide the answers for the questions like why expend on this (King, 2010). In the same situation, Lusardi and Mitchell (2007) defined financial literacy is people's genuine capability to understand how to run their finance. The Organization for Economic Cooperation and Development (OECD, 2013) and Atkinson and Messy (2012) defined financial literacy as: mixture of financial awareness, knowledge, skill, attitude and behavior necessary to make healthy decisions regarding finance to attain financial welfare. Financial literacy can be defined as the capability to use financial understanding and skills to administer financial resources successfully for long lasting financial wellbeing.

Various studies have been conducted regarding financial knowledge/literacy/ by various scholars. (Hilgert, et al., 2003; Lusardi and Mitchell, 2014; Hung, et al., 2009) and Clark, et al.,(2015) suggested that Financial knowledge is human's understanding of financial issues such as, interest, deposits, time value of money and inflation. Having financial knowledge is necessary when the choice of financial products is increasingly complex, with products easily accessible by various depositors and investors. Few basic definition of financial literacy presented as follows

- ❖ Financial literacy is a fundamental knowledge about finance in which the community require in order to stay active in a modern society' (Kim, 2001) Financial knowledge is described as understanding of key financial terms and concepts needed to perform daily tasks in the community' (Bowen, 2003).
- ❖ Financial literacy is the capability which aids a person to make a sound decision in their financing activity. people who have financial knowledge simply can understand the financial concepts like risk , interest rate ,rate of inflation and rate of interest' (Huston, 2010).
- ❖ Financial literacy is the capability to use knowledge and skills effectively in managing the financial resources. (PACFL, 2008).

### 3.2. Determinants of Financial Literacy

Number of studies has been conducted to detect the factors that affect the financial literacy.the determinants were varying with the nature of studies. According to the sutudy employed by Ford and Kent (2010), suggested that lower level of financial market awareness vulnerable in women than compared to men. It also assessed information about females and males college students.the result showed that males are much more interested in financial market awareness. voluminous research investigated demographic and socio economic variables affect financial knowledge such as (Kadoya & Khan, 2020; Garg & Singh , 2018; Cucinelli et al., 2019). Yoshihiko and Mostafa (2020) , also affirmed that level of financial literacy affected by demographic factors such as gender, age, and education; the socio-economic factors of income and occupation. But the study conducted by Sucuahi (2013), conclude that financial literacy not influenced by gender. This results gender has not significant impact on financial literacy. Bağcı (2019), also affirmed from the survey distributed to 602 people in turkey that gender has not significant influence on financial literacy since the women has got and equipped financial information. Gender no matter if women strive to seek information of finance and get ready to apply the financial matters equally with men.besides, Ibrahim et al., (2016) mentioned that Financial awareness does not differentiate by sex because of equal understanding of financial terms and concepts.they suggested that sex has not significant effect on financial literacy.

Individuals with extended work experience can pass through a larger number of financial conditions and they gain more knowledge of finance thus it providing a basis for decision making. On the other hand, individuals who have not work expected to have low level of financial knowledge. According to Research (2003), those who are inexperienced and out of job (unemployed) workers tend to show lower performance due to less contact with financial issues. In addition to this, financial illiteracy results with low job performance and workers' productivity (Kim and Garman, 2004). Working arrangements may also influence financial attitudes and behaviors.

Studies shown that low income results lower financial literacy level. It has massive influence to build up financial knowledge. According to Calamato and Maria (2010), individuals with stable income have better chance to organize and plan their financial life. Monticone (2010), also found that affluence has a small extent, but positive effect on financial literacy. Studies like, (Hastings & Mitchell, 2010) provided experimental evidence to show that financial literacy is related to wealth. According to Johnson & Sherraden (2007), they revealed from the assessment of financial literacy that students from affluent families had significantly higher knowledge levels than students from low-income families.

In the same way, individuals who have low income are vulnerable to drop out of school and something that contributes negative impact to their financial illiteracy (Calamato and Maria, 2010). From this empirical result: individuals with high financial literacy levels will make better financial decisions and achieve higher income from individuals with low financial literacy levels. cultural difference also one of the main determinants for the enhancement of financial knowledge. rare studies affirmed its effect on financial literacy. According to the study conducted by Brown et al., (2017) concluded that dissimilarities in culture has a massive implication on the attainment of financial literacy. Agyei (2018), suggested about influence of culture on financial knowledge collected from 300 samples of Ghanaian SME- Owners and affirmed that cultural values highly affect financial literacy level. he also recommended the cultural beliefs of those owners should be considered in designing the programs related to financial literacy.

### **3.3. Measurement of financial literacy**

High level of financial literacy is the essential tool in maintaining financial wellbeing. To have such level financial knowledge should be measured and improved. Measuring financial literacy enhance individual's financial knowledge. Having financial literacy skill could support someone to evade the challenges relating to financial conditions (Yuesti et al., 2020). There is no a constant valid strategy (methods) in measuring financial literacy (Remund, 2010). instruments is differing based on their study. financial literacy level measured by number of scholars aiming to know one's abilities to make an outstanding financial decision.

Various scholars have used different techniques to measure financial literacy such as performance test, self-report test, objective test and self-assessment tests. Performance tests based on knowledge-oriented questions corresponding to definitions. However, self-reports evaluate self confidence in knowledge such as a question like how much you know about saving etc. Self-assessment is a technique used to evaluate financial literacy skill of individuals by asking respondents about financial attitude toward financial decisions, knowledge and information. However, the objective measure examine respondents' knowledge of financial terms (assets and liabilities), understanding of various financial concepts (interest rate and inflation rate) and ability to apply numerical skills in particular situations related to finance. Study by Jappelli (2010) used the self-assessment technique to examine financial literacy level of 55 nations. He concluded that 'The financial literacy of population from those 55 nations is high'. Objective measure was used by different scholars to examine literacy. (Panos & Klapper, 2011; Almenberg & Söderbergh, 2011) used objective measure test to assess financial literacy in Russia and Sweden respectively by asking respondents about inflation rate, compound interest and risk diversification. The study conducted by Almenberg & Söderbergh (2011) in Sweden that was suggested that highest level of literacy was shown at the age 35-50 years. However, the lowest skill was belonging to those more than 65 years.

According to Panos & Klapper (2011) showed that financial literacy is considerably lower in the rural areas of Russia. Third, we find some indication that differences in financial literacy can also be identified among different ethnic groups. According to their study, proportions of the answers for compound interest calculations, only 36% of respondents provide the right answer whereas 30% chose wrong answer and 33% indicated they could not estimate the answer even roughly. From the study of Dewey and Prince (2005), they measured financial literacy based on The Survey of Health, Age and Retirement in Europe (SHARE) from eleven

European countries. They conclude by testing respondents that 'there is an ability to work with mathematical calculations and understanding simple economic terms.

Financial behavior refers to human's action with respect to money management. Financial behavior is a positive or negative personality of individuals in relating to money management (Xiao, 2008; Woodyard, 2013). Positive financial behavior comprises making deposits, conducting credit management, managing cash, making savings provision for emergencies, and setting up long-term goals, like pension for retirement. Whereas negative financial behavior includes hesitation to discuss about finance, being extravagant when u received money and depend on employer pension plans. On the other hand, Financial attitude in finance refers to values and beliefs like long term thinking, self-control and patient to solve the financial problem (Priyadarshini, 2017). Financial attitude focuses on the ability to believe in own self for instance, believing it is important being patient while facing financial problem, searching ways to diversify the risk, understanding risk and returns and believing it is essential to deposit money (Diacon & Ennew, 2001).

#### 4. Conclusion and recommendations






##### 4.1. Conclusion

Financial literacy has been defined in different ways. It is way of understanding the financial concepts and procedures and attaches this awareness to solve the financial obstacles. It is awareness about financial terms/concepts like, compound interest, inflation, time value of money and saving. financial knowledge is the ability to use both financial understanding and skills to assure the existence of financial wellbeing. The access to know about how to administer and run the business, how to expend and save and how to make the an informed decisions are part of financial literacy. Higher financial literacy leads to sound financial decision relating to retirement and saving. Financial knowledge is getting low at all levels due to lack of financial education. Women's financial knowledge is lesser than men's interms of financial market awareness. females has less interested in financial market aware as compare with males. Nearlyly all of the demographic and socio economic variables have significant impact on financial literacy except that debating area of gender. work experience is one factor of financial literacy. those having longer work experience have an access to get more financial knowledge since they passed through larger number of financial transactions. Individuals who earn more, the access to financial literacy greater. Students from wealthy families have better financial knowledge than less wealthy (poor) families. Besides, cultural beliefs has massive influence on financial knowledge.

There is no constant accepted financial literacy measurement that has been adopted. it depends on the study aiming to know one's abilities to make an outstanding financial decision. different methods has been employed by different scholars to measure financial literacy like as performance test, self-report test, objective test and self-assessment tests. Self-assessment is a technique used to evaluate financial literacy skill by asking individuals about financial attitude toward financial decisions and financial knowledge. Conversely, the objective measure examine level of financial knowledge in a question respective of financial terms and financial concepts such as assets and liabilities, interest rate and inflation rate. In addition to this individuals' financial behaviour and financial attitudes taken as a financial literacy component but not as measurement.

##### 4.2. Recommendations

To make considerable improvements in the Financial Literacy situations the following measures and actions should be taken.

-  Identifying the main determinants and take a remedial measure.
-  Providing favorable means of financial education to reach at the community such as symposium and seminar.
-  Offering training them about how to manage their own finance.
-  Convincing them about the impact of financial knowledge on their life and their business if it triggers to need of learning.
-  Financial behavior and financial attitudes should be taken as a measurement in order to seek better means of evaluation.

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