THE IMPACT OF FINANCIAL LITERACY ON FINANCIAL BEHAVIOR: A LITERATURE STUDY

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ABSTRACT

Financial literacy has greater importance in our society as the result of the innovation in financial products and challenging economic landscape. It's also explained on the attitudes toward saving and financial management practice. In fact, individuals who possess low financial literacy and do not have a proper budget plan or practice financial discipline brings inevitably to the issue of mistakes. A survey by Bank Negara Malaysia (BNM) revealed that a majority of 3000 Malaysian does not practice proper budget plan. Therefore, this paper will carry out literature review to discuss the impact of financial literacy on the financial behaviour. It is expected to shed light on the level of financial literacy in Malaysia and measures taken to promote better financial behaviours among public. Various sources of secondary data were utilized to assist the discussion on the level of financial literacy, financial literacy and financial education. Major significant factors influenced the level of financial literacy among individuals but it is varying according to age, income level, gender and family background. It is expected that many, if not most people really needs for financial literacy improvement to make important financial decision in their own best interests, and this should be started in the early childhood.

Keywords: *Financial literacy, financial education, financial behavior*

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1. Introduction

Amidst current economic conditions in the global economy, it is now become importantly for people to be more competent and knowledgeable in managing their personal finances. Due to an innovative financial products and services, making a financial decision becomes more complicated. Thus, individual should be equipped with good financial knowledge, financial capabilities, good financial behavior and skill to make a wise financial decision.

At a macroeconomic level, financial literacy benefits entire nation and economic development of major countries. The countries with the highest financial literacy rates are Australia, Canada, Denmark, Finland, Germany, Israel, the Netherlands, Norway, Sweden, and the United Kingdom, where about 65 percent or more of adults are financially literate. On the other end of the spectrum, South Asia is home to countries with some of the lowest financial literacy scores, where only a quarter of adults or fewer are financially literate. (S&P Global FinLit Survey, 2014). A survey on 8000 people has been done and according to MasterCard Financial Literacy Index 2014, basic financial knowledge and skill across Southeast Asia fell in major countries including Indonesia, Malaysia, the Philippines, Singapore, Thailand and Myanmar. Indonesia and the Philippines scored the lowest in the region. Financial literacy has created relatively widespread knowledge shortfalls. On another matter, the *Star Online* dated 29 April 2016 reported that:

i. Malaysian substantial household debt, which accounts for 89% of GDP.
ii. Many Malaysians were still falling for scams and get- rich- quick scheme because they did not understand financial products.

Additionally, the *Malay Mail Online* dated 26 November 2015 revealed the surveyed by Central Bank of Malaysia in which, debt levels are especially acute for Malaysians earning RM1,500 and below, averaging at 14 times their annual income. It is very disturbing as 93 per cent of the survey respondents earn a monthly wage of RM3,000 or less individually while 93 per cent of the households earn RM5,000 or lower. On another related issue, The *Star Online* dated 9 April 2014, Wednesday reported that bankruptcy cases on the rise in Malaysia. Indeed, most cases reported by Malaysian Department of Insolvency (MDI) arise from the sale and purchase of vehicles, making up 26.54% of the total cases between 2007 and 2014.

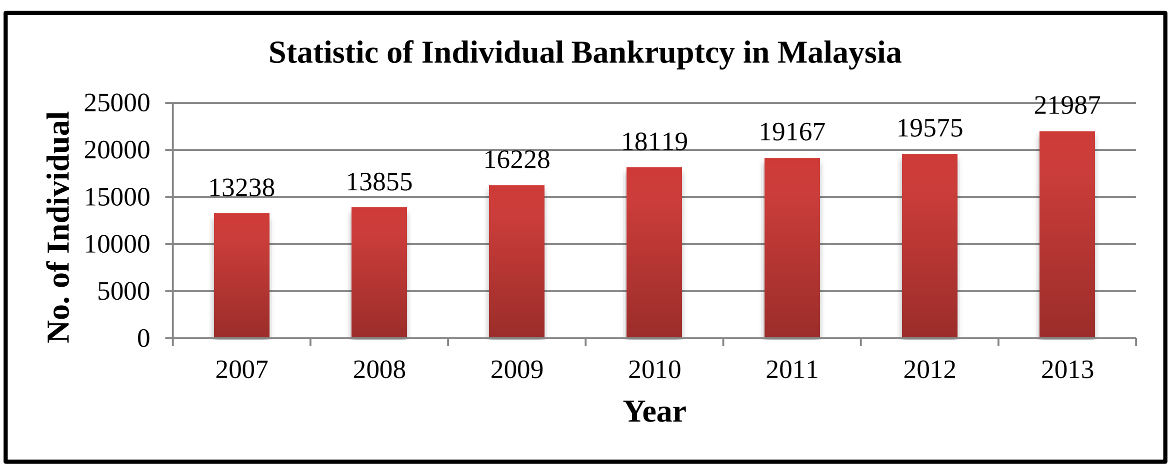

Figure 1. Statistic of Individual Bankruptcy
(Source: The *Star Online* dated 9 April 2014).

The report showed that the number of bankruptcy cases keep on increasing consistently. In fact, according to MDI the total number of bankrupts as of December 2013 was 253,635. The above data provide negative indicators on the financial conditions of

Malaysian citizen. This situation will eventually lead to many financial problems to the household and ultimately to the nation. In this case, financial literacy becomes increasingly crucial to every individual as an essential tool to manage their money wisely and spending habits within it means.

Thus, the objective of this paper is to discuss and highlight the impact of financial literacy on the financial behavior. Discussion will emphasize on the level of financial literacy, financial education and financial literacy. It is postulated that higher levels of financial literacy will eventually have a positive impact on individual financial behavior. Lack of financial knowledge, awareness, and inappropriate plans may bring negative impact to long term quality of life.

2. Literature Review

2.1 Financial Literacy

Financial literacy can be defined as the ways how people manage their money in terms of insuring, investing, saving and budgeting (Mahdzan & Tabiani, 2013). Financial literacy also defined as the ability to use knowledge and skills to manage financial resources effectively for a life time of financial well-being (Suwanaphan, 2013). It also refers to a skill that can help people to make financial decisions effectively. Therefore, individuals who are financially literate are expected to possess basic understanding of the financial concepts such as interest rate, inflation rate, compound interest, and risk (Sabri & Juen, 2014). According to Taft et al. (2013), financial literacy including awareness and knowledge, financial instruments and their application in business as well as personal life. Financial literacy consists of knowledge; capability and mental cognition which help individuals effectively manage their financial assets and resources for their happy later life. It can be expressed in three aspects which are right understanding of financial theory and products, assessment and tendency in financial environment and capability of using financial tools to complete capital planning (Chen, Wang, Yang, & Yuan, 2014).

Major findings show that, financially literate people would have better knowledge and skill on how to manage their financial affairs. Indeed, many factors were actually influenced the level of financial literacy among individual. In today's challenging financial landscape, individual and household needs are increased, and definitely stimulate the demand for various types of financial products. Therefore, having a high level of financial literacy can ensure individuals to place more concern in planning their spending and savings in order to achieve a satisfactory level of financial well-being (Ali, Rahman, & Bakar, 2013). However in Shanghai China, income levels and financial knowledge levels are not perfectly correlated (Chen et al., 2014). The residents are really need for financial knowledge to improve their lack in calculations ability.

Mahzan & Tabiani (2013) have found that the financial literacy is an important determinant of individual saving behavior. On the other matter, financial literacy also associated with level of household income. In fact, low levels of financial literacy could be associated with low education and income levels. Another finding explained that financial literacy is lower among respondents with low wealth; those who are divorced, widowed, or separated; and among African-Americans and Hispanics (Annamaria Lusardi & Peter Tufano, 2009).

Gender factor was also found to influence financial literacy. Lusardi & Mitchell (2014) explained women are less likely to answer financial literacy questions correctly than men, they are also far more likely to say they 'do not know' an answer to a question, a result that is strikingly consistent across countries. However, the average score of financial knowledge for male was 58.15 points while for female was just 49.17 points. Reflecting the financial knowledge level for male is better than for female, which is also the same with foreign research conclusions (Chen et al., 2014). This evidence was consistent with Lusardi and Mitchell (2014) in which women tend to score more poorly on financial literacy questions than men, and the least educated and low income is also less financially knowledgeable.

Another factor that influences financial literacy is age. The actual financial literacy falls with age, peoples' confidence in their own financial decision-making abilities actually increases with age. Finke, Howe, and Huston develop a multidimensional measure of financial literacy for the old and confirm that, though actual financial literacy falls with age, peoples' confidence in their own financial decision-making abilities actually increases with age (Annamaria Lusardi & Olivia S. Mitchell, 2014). In addition, it is also documented that older women have low levels of financial literacy and have done little planning for retirement although retirement planning is more common among participants who are financially literate (Ahmad, Simun, & Masuod, 2006).

2.2 Financial Education

Financial education is a course of action which is helpful for individuals to gain a better understanding of monetary products, services and concepts. (Mian, 2014). The discussions and efforts on sustaining financial literacy will be not being achieving without financial education and financial capability. Indeed, both financial education and financial literacy are strictly connected. The terms financial literacy, financial knowledge and financial education often are used interchangeably in the literature and popular media (Azmi & Chong, 2014).

Financial education plays importance roles in achieving high level of financial literacy. Indeed, concerted efforts were taken by the Malaysian government to nurture and educate people to be a better person in making wise financial decisions. For instance, Pocket Money Book programme has been introduced in 1998 by distributing 7.9 million copies for students throughout Malaysia, financial education website for students, and workshop for teachers and students. These programme inculcated students at young age in managing and controlling their personal finance. On another matter, financial education is positively correlated with financial literacy. Several studies show that higher level of financial education will eventually affect the level of financial literacy. Typically, financial literacy and/or financial knowledge indicators are used as inputs to model the need for financial education and explain variation in financial outcomes such as savings, investing and debt behavior (Huston, 2010). In general, positive relationships have also been found between personal financial literacy and level of education, participants with a higher level of education (Shaari, Hasan, Kumar, & Haji, 2013).

Central Bank of Malaysia has included the need for enhanced financial education at national level by collaborating with Ministry of education (MOE) to integrate financial education into school curriculums. Additionally, efforts also continuously executed for adult financial education by Credit Counseling and Debt Management Agency (AKPK). Realizing an important of financial education and financial literacy, US Federal Government established Office of Financial Education in the US Treasury Department and the National Financial Literacy and Education Commission (Mian, 2014). This was their national level strategy to promote financial education and financial literacy. Mian (2014) also revealed the research findings on the impact of financial education on American household savings. It showed that adults who possess low financial literacy will definitely make poor financial decisions. Nevertheless, individual with higher level of financial literacy were more aware of their saving situations, inclined to save more and gain financial security as well as higher economic grades. This finding indicates that, financial education is a crucial tool for an individual to attain an effective financial literacy. Supported by Klimontowicz (2015) the financial education, as the process by which people improve their financial literacy, may influence their financial awareness, while choosing financial services and enhancing the knowledge on various types of products and their features (Klimontowicz, 2015).

It is important to stimulate financial education to young generation as it can provide necessary skill and knowledge for them to make an informed financial decision making. Furthermore, initiatives on enhancing financial literacy through financial education will also help them to maintain healthy financial behavior towards achieving financial well-being. Mandell and Klein (2009) did find evidence, supporting the presence of student motivation as a factor in increasing the financial literacy of respondents, indicating that motivated adults benefit from targeted financial education.

However, based on previous study, researchers may need longer period to scrutinize the accurate relationship between financial education and financial literacy. Some researchers found a mixed result in the effectiveness of the financial education towards financial literacy. Nonetheless, a well- defined and proper implemented financial education programs in high school can increase students’ financial knowledge (Azmi & Chong, 2014). Eventually, effective implementation of financial education is seeming to influence the level of financial literacy and behaviors among individuals. Suggested that financial education seminar has been found to increase college students’ financial knowledge and responsible attitudes toward credit while reducing their avoidant attitudes toward credit (Ahmad et al., 2006). Indeed, another finding explained, a positive financial literacy scores and financial behavioral for those with a full-time college education may have resulted from receiving additional personal finance education (Mandell & Klein, 2009).

Thus, suggested that if the government aims to increase saving amongst households, it should increase efforts in promoting financial literacy through basic educational programs regarding financial issues (Mahdzan & Tabiani, 2013). Consequently, based on the above discussion, there is a pressing need for Malaysian to strengthen financial education in order to enhance their financial capability and establish the right financial behavior.

2.3 Financial Literacy and Financial Behavior

Indicators of good financial behavior can be measured through the investment activities involved by individual. It is also related with consumer borrowing, credit card financing and saving/budgeting, as well as their ability to use quantitative ability to support financial decision making. Financial behavior can be further explained using life- cycle theory/ hypothesis. According to Ahmad et al., (2006), the life-cycle theory has been used to explain financial behaviors, especially those related to savings. Established by Modigliani, this theory was the greatest idea in the Modigliani crown. It provides consistent and rational explanation for most empirical findings on saving. Indeed, the Life-Cycle Hypothesis is antipodal to the Marxian theory of saving, which has rich capitalists as the only savers. In its most basic form with no bequests, homothetic utility and perfect capital markets, the Life-Cycle Model holds that all—poor as well as rich—save for retirement (Merton, 1987). This theory posits that, saving will rise as income increased.

Major previous studies showed that financial literacy is positively related to self-beneficial financial behavior. In terms of financial behavior, those with lower education exhibit less favorable financial behaviors. Those who only have school certificate rated lower good financial practices, compared to diploma holders and higher.(Ahmad et al., 2006). This finding further supports that financial literacy has positive influence on financial behaviour. According to Mian (2014), financial literacy can have direct implications on financial behaviour. People with low financial literacy are more likely to:

i. have problems with debt.
ii. less likely to participate in the stock market.
iii. less likely to choose mutual funds with lower fees.
iv. less likely to accumulate wealth and manage wealth effectively.
v. less likely to plan for retirement.

More interesting, quantitative literacy (QL) and subjective numeracy, each contribute uniquely to explaining financial behavior. Quantitative Literacy (QL) refers to the competency and comfort in working with numerical data. Meanwhile, subjective numeracy is based on their level of experience, interest, ability, and preference with numerical tasks. The finding indicates that higher income, greater assets, better education, and stronger numeracy are positively associated with financial literacy and financial behavior (Nye & Hillyard, 2013). In addition, parents influence their children overtly and cognitively through direct teaching, reinforcement and purposive modelling. Children acquired knowledge, attitudes, and motives on most subjects that might be included in education about the consumer role before coming into the classroom. This is to show that family, especially parents, have a huge impact on the financial behavior and literacy of an individual (Albeerdy & Gharleghi, 2015). Indeed, a good financial behavior will positively affect savings, retirement planning, risk management and credit management. Consumers who are more confident in regards to their own financial knowledge actually engage in more favorable behaviors (Robb & Woodyard, 2011). Therefore, person who engages in good financial behavior will be more satisfied financially.

3. Discussion and Conclusion

The findings of the previous research show that many significant factors influenced financial behavior of an individual. The level of financial literacy, level of education, income, age and other external factors contributes to a good financial behavior. Poor financial literacy and financial education will positively associate with a bad behavior such as over-indebtedness. Since financial literacy is not only affecting the quality of life, the financial authority will definitely take effective measures to overcome many difficulties due to lack of financial literacy. It is important that, at macro level, financial literacy will also affect the economic development of a particular country.

Past research has proven that most of the students from secondary and tertiary levels are still weak in managing their own pocket money. As to inculcate good financial behavior, financial education is one of the major parts of the enforcement. Thus financial education program and seminar serve as a complement to any other policies implemented by the government intensively. Indeed, at national level, Central bank of Malaysia has concerted many financial education programmes for students in order to promote better level of financial literacy.

It is a responsibility for all to strengthen our financial knowledge and financial management skills, from school level to every household. From the above literature, we can perceive that higher financial assurance, knowledge, and satisfaction are related with better financial behavior. In a current economic environment and increasing burden, people must have higher level of financial literacy for them to make financial decision related to retirement, risk management, credit management and emergency cash. In relation to this, the authorities should enforce relevant policies and create awareness to facilitate all measures taken by individual.

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