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A Study on the Factors Determining Financial Literacy of Households

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Abstract— **India has been ranked 23rd out of 28 markets in Visa 2012 Global Financial literacy barometer. Financial literacy has gained the attention of a wide range of major banking companies, government agencies, grass-roots consumer and community interest groups, and other organizations. Ineffective money management can also result in behaviors that make consumers open to severe financial crises. Improved financial literacy can benefit individuals and families by giving them more control over their money and helping them make better financial decisions. This research paper finds the factors affecting the financial literacy.**

Research Findings /Results

The basic demographic data were also collected. The study revealed that financial literacy is influenced by six factors, they are Managing Debit and Credit, Confidence and attitudes, Skills, Personality, Knowledge and understanding and Future financial planning and the study proved that the financial literacy is the powerful predicator of demand for financial consultancy services.

Tools used: Factor analysis, Correlation

Practical implication

The benefits of a financial literacy on a personal level can be individuals may save more, and better manage risk. There may even be general equilibrium effects: increased demand by households for financial services may improve risk-sharing, reduce economic volatility, improve intermediation, and speed overall financial development. This in turn could facilitate competition in the financial services sector.

Index terms - Literacy, Financial services, Households, Factor, Correlation

I. Introduction

A. Financial literacy

In recent years, financial literacy has gained the attention of a wide range of major banking companies, government agencies, grass-roots consumer and community interest groups, and other organizations. Interested groups, including policymakers, are concerned that consumers lack a working knowledge of financial concepts and do not have the tools they need to make decisions most advantageous to their economic well-being. Such financial literacy deficiencies can affect an individual's or family's day-to-day money management and ability to save for long-term goals such as buying a home, seeking higher education, or financing retirement. Ineffective money management can also result in behaviors that make consumers vulnerable to severe financial crises.

From a broader perspective, market operations and competitive forces are compromised when consumers do not have the skills to manage their finances effectively. Informed participants help create a more competitive, more efficient market. As knowledgeable consumers demand products that meet their short- and long-term financial needs, providers compete to create products having the characteristics that best respond to those demands. As concern about financial literacy has increased, so too have the number and variety of financial literacy training programs and program providers—some offering comprehensive information on savings, credit, and similar topics for a broad audience and others tailored to a specific group, such as youth or military personnel, or focused on a specific goal, such as home ownership or savings.

B. Definition of Financial literacy

The National Foundation for Educational Research, for example, defined financial literacy as "*the ability to make informed judgments and take effective decisions regarding the use and management of money*" (Noctor et al, 1992).

"Financially capable people are able to make informed financial decisions. They are numerate and can budget and manage money effectively. They understand how to manage credit and debt. They are able to assess needs for insurance and protection. They can assess the different risks and returns involved in different saving and investment options. They have an understanding of the wider ethical, social, political and environmental dimensions of finances."

"Financial literacy could therefore be defined as an *individual's ability to obtain, understand and evaluate the relevant information necessary to make decisions with an awareness of the likely financial consequences" (Mason and Wilson, 2000).*

C. Aspects of Financial literacy

According to some experts financial literacy has four discrete aspects:

- Managing money.
- Planning ahead.
- Making choices.
- Getting help.

People discussed the issues about knowledge, understanding, skills, attitudes, confidence and personality in the context of their behavior in relation to these four activities. They felt that personality, confidence and attitudes were inextricably bound up with knowledge and skills, with the outcomes reflected in behavior.

Managing money
Financially capable people needed to be well organized, particularly when it came to paying bills, and keeping and using financial records.

Planning ahead
This is required for two purposes: to cope with unexpected events and to make provision for the long term.

Making choices
Given the array of financial products available, being aware of what was on offer and being able to choose those that were most appropriate to an individual's circumstances were important aspects of financial literacy.

Getting help
This had two dimensions: self-reliance and using third parties. First, people should be able to gather information for them. Secondly, a financially capable person would know where and when to turn for advice and help from a third party. They would also be able to judge how much trust to place in the information and advice provided.

II. Related Work

The table shows the reviews on financial literacy and their findings.

Refer Annexure I

III. Research Methodology

A. Methodology

This study has been conducted on the sample with the assumption that the result which is got from this sample may be same as result which may be got from population.

Researchers collect information by a wide variety of methods, ranging from the experimental designs used in the physical sciences through to the surveys more common in the social sciences. Here the researcher has used purposive sampling which relies on the judgment of the researcher as to who should be in the sample.

B. Validity test

In order to reduce the possibility of getting the wrong answer two issues on research design is required to be mentioned: Reliability and Validity.

Validity is concerned with whether the findings are really about what they appear to be about (Saunderes). Validity is defined as the degree to which data collection method or methods accurately measure what they are intended to measure. Following steps were taken to ensure the validity.

- Literature review has been made clearly
- A content validity questionnaire has been prepared and it has been given to subject experts.

Content validity questionnaire has been given to some experts. In that questionnaire, they are asked to rate each statements as essential, essential but unimportant and not essential. After collecting these questionnaire, it will be analyzed and find out the CV ratio. In this study most of the experts rated more essential for each statements. And some questions have been removed from the questionnaire. The questionnaire is started with demographical data. The questionnaire includes 30 statements. The respondents are asked rate each statements on a five point rating scale.

RELIABILTY: Reliability refers to the degree to which data collection method or methods will yield consistent findings, similar observations would be made or conclusions reached by other researchers or there is transparency in how sense was made from raw data. Following steps Numbers of different steps were taken to ensure reliability.

1. Questionnaires were distributed in different days selected randomly.
2. Alpha cronbach test has been calculated.

Cronbach alpha test
Cronbach's alpha is the average of all co efficient resulting from different ways of splitting the scale items. This coefficient varies from 0 to 1, and a value of 0.6 or less generally indicates unsatisfactory internal consistency reliability.So result on reliability test has been shown below

	Cronbach alpha	Number of items
Factors affecting Financial Literacy	0.81	36

As the cronbach's alpha is more than 0.6, this study is reliable.

IV. Analysis and Interpretation

After data are collected, proper tools and techniques should be used for classification and analysis of data. Here the researcher used following analysis tools.

1. Factor analysis
2. Correlation

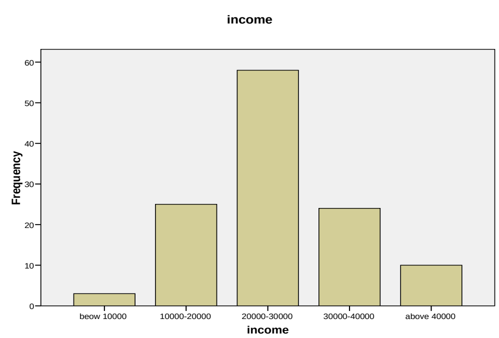
Factor analysis
Factor analysis is a statistical method used to describe variability among observed variables in terms of a potentially lower number of unobserved variables called **factors**. In other words, it is possible, for example, that variations in three or four observed variables mainly reflect the variations in a single unobserved variable, or in a reduced number of unobserved variables.

Correlation

In statistics, **Spearman's rank correlation coefficient** or **Spearman's rho**, named after Charles Spearman and often denoted by the Greek letter ρ (rho) or as r_s, is a non-parametric measure of statistical dependence between two variables. It assesses how well the relationship between two variables can be described using a monotonic function. If there are no repeated data values, a perfect Spearman correlation of +1 or −1 occurs when each of the variables is a perfect monotone function of the other

Descriptive statistics

Here, we describe the samples on the basis of their some features like age, gender, income group, occupation etc. More respondents were from 35-45 age categories. 35% of the respondents were from this age category. Least numbers were from above 55 age category. 33.3% of the total respondents are from 21-25 age categories. The descriptive statistics of educational qualification shows that more respondents were from under graduates.



Source: Analysis of data collected

V. FINDINGS OF FACTOR ANALYSIS

For the factor analysis, a questionnaire which contains 30 statements has been given to the respondents. The respondents were asked to rank in a five point rating scale. From these 120 questionnaires, different components of financial literacy have been found out using factor analysis.
To find out the factors affecting the financial literacy, the researcher has done factor analysis. From this study it is revealed that financial literacy has six factors.

1. Managing Debit and Credit
2. Confidence and attitudes
3. Skills
4. Personality
5. Knowledge and understanding
6. Future financial planning.

Managing Debit and Credit

It is the ability to manage debit and credit. Debit and credit are two very important factors which are to be managed very well. Otherwise gap in holding cash will be there. From this study the Researcher found out the statements which are coming under this factor

- I have the ability and understanding to manage my debts
- I have the ability and understanding to manage credit
- There is no better way of savings money than paying off debt early
- I will not get into debt. (If I can't afford it, I will not buy it)
- I feel comfortable with my level of debt.

Confidence and attitudes

As the researcher explained above, attitudes towards finance is very important. Because it affect a customer to think about his financial plans and helps to select the different type financial instruments. So it is very important to understand the attitude of customers towards financial literacy. Here the researcher identified the statements which are related to this.

1. Dealing with money is not stressful
2. Thinking too much about my long term financial future, makes me feel uncomfortable.
3. Dealing with money is not boring
4. I have the ability to understand financial terms
5. Money is not just a mean to buy anything
6. Financially I don't like to live for today**.**

Skills

As explained before, People also need the ability to apply their knowledge and understanding in order to manage their money and to make appropriate financial decisions. This calls for a range of specific skills, which need to be underpinned by basic levels of literacy and numeracy. Here the researcher has found out the statements which are related to this

1. I have the ability to budget my day to day finance
2. I can easily track my every spending
3. I think about ways to reduce my spending
4. I don't have problems with setting money aside for big purchases.

Personality

Personality was also seen to be an important factor. It had a bearing on confidence, shaping people's ability to say 'no', and on their propensity to take action. It also conditioned the way they behaved: whether or not, for example, they were well organized. Here the researcher has found out the statements which are related to

1. Financial planning is only important for those who have a lot of money
2. Nothing I do will make difference to my financial situation

Knowledge and understanding

This is the ability to make sense of and manipulate money in its different forms, uses and functions. Financial knowledge and understanding allows people to acquire the skills they need to deal with everyday financial matters and make the right choices for their needs. Here the researcher has found out the statements which are related to. They are

1. I have the ability to ensure enough money for my retirement
2. I have the ability to invest money.
3. I have the ability to save money

Future Financial Planning.

This is the ability to plan future financial needs. It is very important because every one may need some financial needs and wants in their future. So it should be planned well. Here the researcher has found out the statements which are related to. They are

1. Retirement is too far away for me to think about it
2. I save money for emergency funds
3. I have long term goals and save regularly for achieving the long term goals
4. I have the ability and understanding to manage my long term financial future
5. I have long term goals and save regularly for achieving the long term goals

Factors of Financial Literacy

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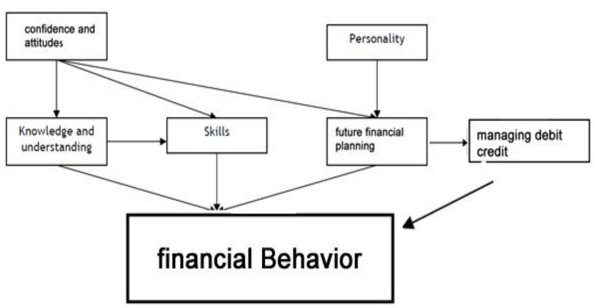

VI. RESULT

A. FINANCIAL LITERACY IS A STRONG PREDICTOR FOR THE DEMAND OF FINANCIAL CONSULTANCY SERVICES

To prove that financial literacy is powerful predictor for the demand for financial consultancy services, a correlation study has been done. The correlation study was in between the demographical factors with the following statements.

1. I have the ability to understand financial terms.
2. I have the ability to budget my day to day finance
3. I have the ability in dealing with financial service providers
4. How do you rate yourself on financial literacy
5. I have the ability to ensure enough money for my retirement.

From the correlation study, it is understood that

1. Age and income are positively correlated
2. Gender and ability to understand the financial terms are positively correlated.
3. Educational qualification and financial literacy is positively correlated
4. Financial literacy has positive correlation with getting financial advises, demand for financial advisory services and preferred mode of delivery.
5. Getting financial advises has positive correlation with getting financial literacy, demand for financial advisory services and preferred mode of delivery.

VI. CONCLUSION

The study reveals that financial literacy has 6 components; they are Managing Debit and Credit, Confidence and attitudes, Skills, Personality and Knowledge and understanding Future financial planning. There is a great opportunities that is awaiting for the financial services companies. At the initial stage, the company can concentrate on advice on investment options and debt management since they have been given more preferences. Company can teach the common people and low educated people as now they are not much aware about this financial service industry. The benefits of better financial literacy may be great. On a personal level, individuals may save more, and better manage risk, by purchasing insurance contracts. There may even be general equilibrium effects: increased demand by households for financial services may improve risk-sharing, reduce economic volatility, improve intermediation, and speed overall financial development. This in turn could facilitate competition in the financial services sector.

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