Financial Planning: Review and Research Directions of Financial Literacy

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Abstract

In this contemporary world, financial concepts and financial literacy are essential for individual financial planning and economic well-being. The policymaker has embraced financial planning as an antidote for financial crisis to increase the financial literacy. This has encouraged the interest from industrialists, academician and policy makers to explore the study of financial literacy and financial behaviour. This paper provides a critical review of past literature on financial literacy. It emphasizes the study of financial literacy and financial behaviour. The relationship of financial literacy and financial behaviour has been conducted through a systematic review. In addition, numerous similarities and possible discrepancies among the past studies are examined and discussed and future research directions are outlined.

Keywords: Financial Literacy, Financial Planning, Economic Well-being, Financial Behavior, Systematic Review

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Introduction

According to Remund (2010), financial literacy is the ability of an individual understanding financial concepts. It plays an important factor to influence financial behaviour (Klapper et al., 2012). As such, individual’s decision making is developed by their financial literacy on the understanding of financial concepts through different financial instruments. According to Mori et al. (2017), a financially literate person is able to make a better financial decision and obtain greater well-being in as compared to financial illiterate individuals. This has resulted in a fast-growing interest in the financial awareness programs (Freedman & Dursi, 2016) to encourage a good financial behavior. In terms of this, more research needs to be carried out (De Bruin, 2015) relating to how financial behavior can be imparted.

The purpose of this paper is to review past literature from 2005 to 2015 and to assess the development over the period, so as recommendations can be offered in future research. In the process of review, all related articles are categorized as empirical research or descriptive research. Then, it is grouped by different respondents such as students, working adults, housewives and retirees. The division further focuses on the different financial behaviour such as retirement planning, investment planning, financial perspective, and articles related to financial literacy process and structure. The underlying assumptions for using audience segmentation is that financial literacy program objectives, subject matter and pedagogical approach as suggested by Fernandes, Daniel, John G. Lynch Jr (2014).

The following sessions of this paper is divided into five sessions. The first section describes different ways of how financial literacy is defined and some financial literacy measurement with objective-subjective measurements. The second section provides a critical review of previous research about financial literacy and financial behaviour. The third section describes the research methodology of this study and the last section discusses the limitations of this study and future research are addressed.

Literature review

Despite many research on financial literacy, there has been a lack of standardized definition of financial literacy (Schmeiser & Seligman, 2013). The existing measurement lacks consistency to define financial literacy (Selim & Aydemir, 2014). As such, the definition for financial literacy has resulted in the term of 'financial educations' and 'financial knowledge' being used to identify financial literacy (AL-Tamimi, Hussein A. Hassan, Bin Kalli Anood 2009; Smith et al. 2011; Yoong et al., 2012).

There are some various definitions of financial literacy provided in the previous study. In terms of this, Huston (2010, p.306) described financial literacy as "*measuring how well an individual can understand and use personal finance-related information*". Servon and Kaestner (2008, p.273) defines financial literacy as "*a person's ability to understand and make use of financial concepts*". Remund (2010, p. 293) conceptualizes financial literacy as "*a measure of the degree to which one understands key financial concepts and possesses* *the ability and confidence to manage personal finances through appropriate short-term decision-making and sound, long-range financial planning, while mindful of life events and changing economic conditions".* This research has divided financial literacy into two categories such as conceptual definition (Servon & Kaestner, 2008) and operational definition (Lusardi et al., 2010). The conceptual definition is the abstract financial concepts in concrete terms and operational definition is the conversion of conceptual definition into measurable criteria (Remund, 2010).

Furthermore, according Remund, (2010, p.278) all the conceptual definitions provided in the previous studies can be further distinguished into five components "(*1) knowledge of financial concepts, (2) ability to communicate about financial concepts, (3) aptitude in managing personal finances, (4) skill in making appropriate financial decisions and (5) confidence in planning effectively for future financial needs*." These five components are coherent with previous research findings. However, there is no universal definition in the past literature for financial literacy (Huston, 2010).

The measurement on the level of financial literacy is crucial especially for the effect of financial literacy on individual financial behaviour (Lusardi et al., 2010) as well as the needs and the gaps (Schmeiser & Seligman, 2013). According to Huston, (2010), different studies have measured the concept of financial literacy in various ways. However, the measurements used lacks construct clarification (Lusardi &

Mitchell, 2014), not comprehensive (Lusardi et al., 2010) and lacks consistency in instrument interpretation (Servon & Kaestner, 2008).

According to Xiao et al. (2014), financial literacy can be measured by performance tests (objectively) and self-reported methods (subjectively). In addition, existing measurement of financial literacy is dominated by the measurement of objective knowledge (Lusardi et al., 2010; Fernandes et al., 2014). There are also numerous evidences from past literature on large disparity between the measurement of performance tests (objectively) and self-reported methods (subjectively) (Xiao et al., 2014). The recent study from Lusardi & Mitchell (2014) has combined both evaluations of financial literacy that offers "*robust and nuanced insights about how the two different dimensions of financial literacy work together to influence financial outcomes*" (Lusardi & Mitchell 2014, p.7).

Financial Literacy and Financial Behaviour

There is a strong correlation between financial literacy and financial behaviour (Lusardi & Mitchell, 2014). Numerous evidences are suggested that financial literacy is an antecedent to various financial behaviour. The past literature shows that all the financial literacy are done together with the retirement planning (Rooij et al., 2012), wealth accumulation (Yoong et al. 2012), investment choice decisions (AL-Tamimi, Hussein A. Hassan Bin KalliAnood, 2009), and financial behaviour (Grable et al., 2009).

Rooij et al. (2012) had explored a research on the relationship between financial behaviour and financial literacy. They found that individuals who are more financially literate are more likely to engage in the recommended financial practices to get the retirement planning and emergency fund. They have also concluded that financial literacy is linked to financial practice. In addition, individuals' propensity to invest depends on the perceived control of the outcomes and financial resources (AL-Tamimi, HusseinA. Hassan, Bin Kalli Anood, 2009). Financial literacy is found to influence the individual intentions on wealth accumulation (Lusardi & Mitchell, 2009) and retirement planning (Yoong et al., 2012).

Some of the recent studies focus on financial literacy and financial behavior and the results have shown that both are inconsistent (Fernandes et al., 2014). In Robb & Sharpe (2009), the study shows that students with higher level of financial literacy have exhibited a low financial of responsible behaviour. It concludes that students have difficulty to apply their financial knowledge in their real life. This is because they lack experience in financial decision making. According to Mandell & Klein (2009), they found that there is no difference between individuals' financial behaviour on those who have financial management knowledge as compared to those who do not have financial management knowledge.

Methodology

This paper used a census-type sampling procedure. A panel consists of three reviewers was employed to classify the articles. In this study, all three reviewers are the authors of this paper. Three levels of decision making were utilized from the beginning to the selection and classification of the articles according to empirical and descriptive papers. Then, the articles were grouped by various audiences such as students, retirees, adult learners, women, and others. The categories were also based on financial behaviors such as retirement planning, investment planning, economic well-being, and financial literacy process and structure. Each journal issue was examined by two reviewers to ascertain the appropriate articles for the inclusion of the study. If there was a discrepancy or disagreement between the reviewers, the third reviewer was consulted.

All the papers selected for the inclusion in this review are restricted to those published in scholarly and peer-reviewed publication financial management. This study used 95 selected articles which was divided among the three reviewers. Each reviewer had summarised the articles. These abstracts exhibited the fundamentals of the classification process. Articles were cataloged, first according to the descriptive versus empirical and subsequently according to target audience students, retirees, adult learners, women, and others. Although all the articles were classified as either descriptive or empirical paper, categories occurring within each of these perspectives were not considered mutually exclusive. It was also possible for as article to be assigned to multiple categories. The classification process was carried out with all the three reviewers with a consensus-based decision approach. The discussion concerning the appropriate classification of each article typically lasted for ten to twenty minutes.

Limitations

The limitations of this paper revolved on the scope of all the articles being reviewed. Firstly, all the studies were limited to the published year from 2005 to 2015. Secondly, the studies were placed on scholarly and peer-reviewed research. Thirdly, the focus was on financial literacy and financial behaviour only, other determinants and consequences of financial literacy were not reviewed in this paper.

Future Research Opportunities

The primary objective of this paper is to review on the aspects pertaining to financial literacy. The outcomes reveal that there is a need to clearly define the conceptual and operational definitions of financial literacy. New studies have to be conducted to validate the merits of universal accepted conceptual definitions for financial literacy.

The outcomes of the review show that financial literacy has a significant relationship with financial behaviour (Rooij, CJ, Lusardi, & Alessie, 2012). Nevertheless, financial illiteracy is a prevailing issue around the world (Selim & Aydemir, 2014). Policy makers should conduct future studies on the implementation and evaluation of the strategies. It will improve the financial literacy of the population where the financial knowledge and skill have been identified and improved.

The impact of financial literacy on the financial behavior is larger when financial literacy is measured rather than manipulated (Selim &

Aydemir, 2014). This paper may reflect some omitted variables that create the biasness to the financial literacy measurement. Therefore, future research could focus on the possible omitted variables, such as financial experience, time preference and financial sustainability. All the limited financial literacy has been explicitly linked to these variables with financial literacy and financial behaviour.

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