A CONCEPTUAL STUDY ON THE IMPACT OF FINANCIAL LITERACY LEVEL TO HOUSEHOLD WEALTH IN BANDUNG

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Abstract

For the past years, financial market has offered various products and services that will make consumers easier to manage their financial problems. Consumers have to catch up with the expansion of financial products and services by being financially literate to help them manage their own financial products and service (Greenspan, 2001). Without proper literacy, those financial products and services could lead into other serious financial problems. The purpose of this interpretive paper is to find the relationship between financial literacy and families’ wealth accumulation, and what factors determine both variables. This study collected the secondary data from relevant journals, textbooks, and research publications. Based on literature synthesis, this research was able to produce a simple conceptual framework on the relationship between financial literacy and families’ wealth accumulation. The framework suggested that financial education/ training and knowledge of financial products and services will influence the level of financial literacy, while as moderating factors, wealth background, access to financial products and services, and socio-demographics condition indirectly influence the families’ wealth accumulation process.

Keywords: financial literacy, wealth, families, poverty

1. Introduction

Financial literacy becomes more important nowadays. In this century, financial market offers various products and services that will make consumers easier to manage their financial problems. Therefore, to catch up with the expansion of financial products and services, the consumers have to be financially literate to help them manage their own financial products and service (Greenspan, 2001). Without proper literacy, those financial products and services could lead them into other serious financial problems.

Financial literacy is how individual manage his or her financial resources to make sure that his or her lifetime financial is secured in dynamic circumstances (U.S. GAO, 2014). Several surveys have been done to measure world’s financial literacy index. Unfortunately, the results are quite disappointing, considering that financial literacy is essential right now. A global financial literacy survey, conducted by Leora Klapper, Annamaria Lusardi, Peter van Oudheusden (2015), shows that only one-third adults in worldwide are financially literate.
However, financial literacy levels would rate differently when it comes to several factors, including gender. Empirically, women tend to have lower financial literacy level than men (Fonseca, Mullen, Zamarro, Zissimopoulou, 2012). This statement is supported by the result of previous surveys, which shows that globally, only 35% of men and 30% of women that are financially literate.

As already mentioned, financial literacy affects individual’s financial decisions, including in families. When some families were asked who is responsible for their families’ financial activities; such as paying bills, preparing taxes, tracking investments and insurance coverage, making short-term spending or saving plans, and making long term spending or saving plans; the answers of both parties are matched. Most women said that their spouses are mostly in charge in those activities, while men said that mostly they are in charge in those financial activities. These findings are in accordance to a study which states that cognitive traits, exhibited higher on men, were an important component of financial maker, thus making the husband as the decision taker (Smith, McArdle, & Willis, 2010). However, based on the empirical data, the distribution of financial responsibilities in families is not centralized in one spouse, but it is sensitive with the spouse’s education level. Other than gender gap, previous studies also found that there is positive relationship between financial literacy and wealth. Individuals with higher financial literacy level would have total net worth four times bigger than individuals with lower financial literacy level (Rooij, Lusardi, and Alessie, 2012).

Meanwhile, in Indonesia, OJK National Survey in 2016 shows that only 29.66% of Indonesians are financially literate, it’s a very low number for a country that has score around 67.82% in financial inclusion index. Moreover, World Bank shows that, based on international standards, there are 31.4% of Indonesia people that still living on less than lower middle-income class poverty line. OJK, as an important financial institution in Indonesia, has to increase Indonesian financial literacy level to catch up the increasing of variety of financial products and services. Financial education could be a helper for this problem. Theoretically, financial educations will lead consumers to get more financial knowledge, and more knowledge means that consumers will get better financial behaviours that also will lead them to improved outcomes. A previous study also revealed that the availability of financial educations correlated with the underlying predisposition to save, and significant net contribution to total savings (Bernheim, Douglas & Garret, 2003). There are different types or methods of financial education, and some programs will have different impact for different target. Therefore, it’s important to know the characteristics of the target so the proper financial education will give big impact for the participants.

This study will provide a finding about the impact of financial literacy levels on wealth of families in Bandung. Here are some significant and beneficial achievements that the study is expected to help families in Bandung to gain motivation to increase their financial literacy level, provide previous studies’ findings of financial literacy and preferences in financial products, services, and financial education for financial institutions, consideration for government to make effective financial regulations, and information required by the other parties. The results of this study also may change in the future. Therefore, the future researches about this topic would be encouraged to guarantee the accuracy and achieve the research’s objectives.
2. Literature Review

2.1 Financial Literacy

Financial literacy is a set of someone’s awareness, knowledge, skill, attitude, and behaviour to make proper financial decisions and reach his or her financial well-being (OECD INFE, 2011). Someone can be defined as financially literate if he or she is competent and able to make proper financial decisions based on his/her finance knowledge. The more an individual is financially literate, the more he or she becomes financially sophisticated and competent (Moore, 2003). However, most people are still misunderstanding financial literacy as financial education or knowledge.

Financial knowledge is not same with financial literacy. In financial literacy, there are two dimensions, understanding of financial aspect and its application in real life (Huston, 2010). It means that an individual should be able and confident to apply his or her financial knowledge in making financial decisions. Therefore, in developing financial literacy measurement instrument, both financial knowledge and appropriate application would be important to be determined.

2.1.1 Financial Literacy Framework

Figure 1. Core Competencies of Financial Literacy

Source: G20/OECD INFE Core Competencies Framework of Financial Literacy for Adults (2016)
In 2016, OECD International Network on Financial Education (OECD INFE) released a publication containing a range of financial literacy outcomes that may be important and relevant to improve daily financial well-being. To become financially literate, an individual must have several core competencies of financial literacy. By having a combination of those core competencies, based on individual’s preference, cultural, and economic context, he or she will be able to maintain and improve his or her financial well-being. These core competencies cover:

1. Awareness, knowledge, and understanding. This category relates to all information that has been acquired by the person.
2. Skills and behaviour. This category relates to actions of the person. The actions consist of both required skills to consistently act with achieving good outcomes and behaviours that would likely lead the person to financial well-being.
3. Confidence, motivation, and attitudes. This category captures the internal or psychological mechanisms that may affect decisions, behaviours, and well-being.

2.1.2 Previous Studies of Financial Literacy

There are several previous studies about financial literacy with different objectives. Here are the results of some previous studies:

<table>
<thead>
<tr>
<th>AUTHOR / YEAR</th>
<th>OBJECTIVES</th>
<th>RESULTS</th>
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| Raquel Fonseca, Kathleen J. Mullen, Gema Zamarro, Julie Zissimopoulos (2012) | Examining the role of gender gap in financial literacy, including role of marriage and the financial decision maker | - Men are more focused on financial decisions rather than women within families, therefore they obtain more financial knowledge  
- Empirically, women have lower financial literacy level than men  
- In families, financial decision making processes depend on education level of spouses |
| Gary R. Mottola (2013) | Examining the relationships between credit card behaviours, gender, and financial literacy | - Women tend to engage in more costly credit card behaviour than men  
- Women has lower income level and financial literacy level than men  
- Women also has less confident level of their math ability |
| Maarten van Rooij, Annamaria Lusardi, Rob J. M. Alessie (2011) | To find the relationship between financial literacy and household net worth | - The more individuals are sophisticated in financial knowledge, the more they able to manage their wealth and choose proper portfolio  
- Financial landscape has changed rapidly and could be seen through the complexity of current financial products |
| A Firli (2017) | To find the conceptual framework of financial literacy | Several factors that affect financial literacy level are individual socio-demographic characteristics, financial knowledge, financial behaviour, financial attitude, and financial training. This framework can be a measurement of individual’s financial literacy level. |
| Jeanne M. Hogarth, Marianne A. Hilgert (2002) | To find the relationship between financial knowledge, financial experiences, financial behaviours, and how they can relate to individual’s financial management | Individuals that are married, non-minority, middle aged, have higher education level, and have higher income tend to have higher financial knowledge. Higher financial knowledge individuals have more experiences with financial products and services. Respondents mostly learn about financial management from their experiences, friends and family, and media. They also prefer to learn about financial management from media, brochures, and home videos. |

### 2.2. Household Wealth

#### 2.2.1 Differences between Income and Wealth

Both income and wealth can be the resource of household to fulfil their economic consumptions. However, most people are still misunderstanding income as wealth. Household income is inflow money within the family from several economics activities, such as employments, business, benefits from states, rents of properties, etc. (Keeley, 2015), while
household wealth, or sometimes called net worth, is a household’s assets’ value less the value of all its liabilities at a certain time and usually spread unequally (OECD, 2013). Income can be the main resource to support current consumption, but wealth also can support current and future consumption. Wealth is basically higher on average than income because it is accumulated over time and harder to be measured than income, so there are only few studies that focused on measuring wealth.

2.2.2 Component of Wealth

To identify household’s wealth, a researcher must identify these three components, which are non-financial assets, financial assets, and liabilities. Knowing the composition of wealth can be very useful to understand how the households participate in asset market, the diversification of their portfolio, and what factors can affect their portfolio behaviour (OECD, 2013).

Figure 2. Component of Wealth


2.2.3 Previous Studies of Wealth

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</table>
| Luke E. G. Feudner (2011) | Examining financial measurement of poverty that consists of both income and wealth measurement | • Wealth provides greater financial security (Keister & Moller, 2000; Wright, 2000)  
• In poverty measurement, wealth is usually being ignored  
• Based on both income and wealth, African-American and Hispanic populations are likely to be in poverty than other ethnic groups and the differences were bigger compared to poverty measurement based on income only.  
• Increasing in household head’s age was followed by the decreasing in poverty rates, but in retirement age, it slightly increased again  
• Younger households tend to face wealth poverty  
• Individuals with higher education level are likely to have higher wealth  
• Married households tend to have lower poverty levels than single-headed households |
| Piotr Bialowolski, Dorota Weziak-Bialowolska (2014) | Examining the Italian household financial positions | • Concept of household financial condition is two-dimensional, objective (financial position) and subjective (ability in managing income) and both dimensions are naturally correlated  
• Changes in Italian household financial position coexisted with the Italian financial crisis, but their ability to manage the income improved only until certain times  
• Households with younger head tend to have lower ability to manage household’s budget |
| Baudelaire Augustin, Dimitri Sanga (2002) | Examining the differences between income and wealth as inequity and poverty measurement | • The main difference between income and wealth is, income is flowing per unit of time while wealth is retained at a given point in time  
• Wealth \((t) = Wealth (t-1) - (1+r) + after-tax income (t) + net inter-family transfers (t) - expenditures (t)\) with \(t\) as the present time and \(r\) the constant annual rate of return.  
• The measurement of both income and wealth are related but not perfectly, such as higher income doesn’t always tend to mean higher wealth.  
• At the beginning, income increases faster than wealth  
• In the middle of life cycle, income stays remain while wealth continually grows  
• In retirement period, both income and wealth decrease |
### Eleni Karagiannaki (2012)

Examining the relationship between parental wealth during teenager and their children’s outcomes at age 25

- Children’s education attainment has strongest association with parental wealth, mostly influenced by parental income and education
- Housing wealth has bigger role than financial wealth in children educate attainment
- Financial wealth tends to capture more closely how the financial constraints affect post-secondary educational choices
- Parental wealth has lower impact on the children’s labour force participation
- Children that come from wealthier families will tend to be wealthier as well.
- Parental wealth affects their children homeownership status at 25, possibly because of gifts for house purchase

### Rene Morissette (2002)

Examining which families that susceptible in facing income interruptions or unexpected expenses

- Some families with low income and little or no financial wealth became susceptible financially to income interruptions and unexpected expenses.
- Most families with low income had very low financial wealth
- Most families with low income had zero savings to secure themselves against adverse events in the future
- The wealth gap is getting bigger during the period between low-income families and other families
- Very young families are relatively susceptible in financial problems
- Increasing in earnings from labour market experience makes several families will have low income and low or zero financial wealth in short time
- Prime-aged families of two or more members with no earner are likely to be susceptible financially and lack of education may be the major factor
- The percentage of persons who live in no financial wealth families is not decreasing, that may cause by the increasing of single-parent families and unattached individuals, increasing on length of time young people stay in school before getting a job, decreasing in earnings of young men, easier access to credit, and changes in consumer preferences.

### 3. Methodology

The research is started by identifying the problem then defining the research questions, scope, and limitation. The next step is searching for relevant literatures to support the research. After reviewing the literatures, researcher collects the secondary data, such as journals, textbooks,
research publications that relevant to the research topic. Secondary data is data that collected by other researcher for different research purposes (Hox and Boeje, 2005). The data collected will be analysed to get the results of the research. From the result, the researcher will make the conclusion and give the recommendation relevant to the research.

4. Analysis And Conclusion

Based on the literature review above we can see that financial literacy has plenty of relationship with the accumulation of wealth of the households.

There are also a handful of factors that will influence the financial literacy of one household, such as socio-demographic factors, quality of the network, financial behaviour, financial knowledge, financial education/ training level, and media exposure. All of them directly lead to the financial literacy level, which indirectly will influence the wealth accumulation of the households.

Below is the proposed conceptual framework that can be used to describe the relationship between financial literacy factors and wealth accumulation:
Figure 3. Conceptual Framework for this Study

From figure above, we can know what factors that affect both financial literacy or family’s wealth accumulation, and how both things relate. Financial literacy level is affected by socio-demographic factors (i.e. gender; age; race; education level; income level; marital status; occupation; family size, including number of family members and how many members with earnings); financial education or training; and experiences with financial products and services. Furthermore, the family’s wealth accumulation is affected by the socio-demographic factors; experiences with financial products and services; wealth background (i.e. parental education, income, financial wealth, and housing wealth); access to financial products and services; and financial literacy level. Financial literacy level has strong relationship with wealth accumulation of the family (Behrman, Mitchell, Soo & Bravo, 2012). Financial literacy – that consists of financial knowledge, behaviour, and attitude – affect how the individual manages his or her own daily financial decisions.

5. Conclusion

In conclusion the authors were able to collect evidence of relationship between financial literacy and wealth accumulation. The study is also able to determine factors and attributes that influence the level of financial literacy. Based on the synthesis, we can see that financial literacy is influenced by the socio-demographic factors and what kind of financial trainings or education that the individual received. Moreover, financial literacy also has strong relationship with wealth accumulation because it affects family’s financial decision making processes.

The next step of this study is to check on the conceptual framework using statistical and research analysis, either by qualitative or via quantitative approaches. The results of the study will be beneficial for all stakeholders, including the household itself, financial literacy agents, government, and financial industries.
References


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