Financial Literacy and Saving Behaviour

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Abstract: **A strong foundation of financial literacy can help support various life goals, such as saving for education or retirement, using debt responsibly, and running a business. Key aspects of financial literacy include knowing how to create a budget, plan for retirement, manage debt, and track personal spending. Financial literacy is the ability to understand and effectively use various financial skills, including personal financial management, budgeting, and investing. When you are financially literate, you have the essential foundation for a smart relationship with money. This can help start a lifelong journey of learning about the financial aspects of your life. The earlier you start to become financially literate, the better off you'll be because education is the key to a successful financial future.**

INTRODUCTION

Financial literacy is the cognitive understanding of financial components and skills such as budgeting, investing, borrowing, taxation, and personal financial management. The absence of such skills is referred to as being financially illiterate.

According to the Financial Industry Regulatory Authority (FINRA), about 66% of the American population is considered financially illiterate.

Being financially literate allows an individual to be better prepared for specific financial roadblocks, which, in turn, decreases the chances of personal economic distress. Achieving financial literacy is crucial in today's society due to everyday facets of life, such as student loans, mortgages, credit cards, investments, and health insurance.

The term "financial literacy" refers to understanding a variety of important financial skills and concepts. Financially literate people are generally less vulnerable to financial fraud. Financial literacy can be obtained through reading books, listening to podcasts, subscribing to financial content, or talking to a financial professional.

Scope of Financial Literacy

Although many skills might fall under the umbrella of financial literacy, popular examples include household budgeting, learning how to manage and pay off debts, and evaluating the trade offs between different credit and investment products. These skills often require at least a working knowledge of key financial concepts, such as compound interest and the time value of money.

Financial literacy can cover short- and long-term financial strategies. The strategy you use will depend on several factors, such as your age, investment time horizon, and risk tolerance. Financial literacy also encompasses knowing how investment decisions made today will impact your tax liabilities in the future. Financial products such as mortgages, student loans, health insurance, and self-directed investment accounts have grown in importance. It is imperative for individuals to understand how to use them responsibly. It's also important to know which investment vehicles are best to use when saving, whether for a financial goal like buying a home or for retirement. Other developments in finance such as e-wallets, digital money, and P2P lending can be convenient and cost-effective but require that consumers be educated adequately to use them to their advantage.

Fundamental Components of Financial Literacy

Financial literacy consists of several financial components and skills that allow an individual to gain knowledge regarding the effective management of money and debt. Below are the fundamental components of financial literacy.

1. Budgeting

In budgeting, there are four main uses for money that determine a budget: spending, investing, saving, and giving away. Creating the right balance throughout the primary uses of money allows individuals to better allocate their income, resulting in financial security and prosperity. In general, a budget should be composed in a way that pays off all existing debt while leaving money aside for saving and making beneficial investments.

2. Investing
To become financially literate, an individual must learn about key components in regards to investing. Some of the components that should be learned to ensure favourable investments are interest rates, price levels, diversification, risk mitigation, and indexes. Learning about crucial investment components allows individuals to make smarter financial decisions that may result in an increased inflow of income.

3. Borrowing
In most cases, almost every individual is required to borrow money at one point in their life. To ensure borrowing is done effectively, an understanding of interest rates, compound interest, time value of money, payment periods, and loan structure is crucial. If the criteria above are understood sufficiently, an individual's financial literacy will increase, which will provide practical borrowing guidelines and reduce long-term financial stress.

4. Taxation
Gaining knowledge about the different forms of taxation and how they impact an individual's net income is crucial for obtaining financial literacy. Whether it be employment, investment, rental, inheritance, or unexpected, each source of income is taxed differently. Awareness of the different income tax rates permits economic stability and increases financial performance through income management.

5. Personal Financial Management
The most important criteria, personal financial management, includes an entire mix of all of the components listed above. Financial security is ensured by balancing the mix of financial components above to solidify and increase investments and savings while reducing borrowing and debt. Achieving an in-depth knowledge of the financial components discussed above guarantees an increase in an individual's financial literacy.

Importance of Financial Literacy
Obtaining financial literacy is one of the most important things an individual can do to ensure prolonged financial stability.

Listed below are some real-world facts that should emphasize the overall importance of attaining financial literacy.

- It is estimated that about 78% of Americans live paycheck to paycheck.
- More than 189 million of the American population own credit cards.
- On average, credit card owners own about four cards each.
- Student loan debt is about $1.5 trillion for more than 44 million borrowers.
- Credit card debt levels are at a record high of $1.04 trillion.
- Overall, Americans are approximately $12.58 trillion in debt.

The statistics depicted above should illuminate why financial literacy is paramount in today's financial climate.

Benefits of Financial Literacy
Being financially literate is a skill that brings forth an assortment of benefits that can improve the standard of living for individuals through an increase in financial stability.

Listed below are the assortment of benefits of being financially literate:

- Ability to make better financial decisions
- Effective management of money and debt
- Greater equipped to reach financial goals
- Reduction of expenses through better regulation
- Less financial stress and anxiety
- Increase in ethical decision-making when selecting insurance, loans, investments, and using a credit card
- Effective creation of a structured budget

Where to Gain Financial Literacy
Beyond gaining knowledge through word-of-mouth, there is an assortment of tools and online modules that can increase an individual's financial literacy.

Listed below are some tools an individual can use to increase financial literacy:

- EconEdLink: Online financial lessons for K-12 students.

- Money Smart: Free financial tools such as podcasts, lesson plans, and games to increase financial literacy.
- Money Wise: In a partnership between Capital One and Consumer Action, MoneyWi$e provides free multilingual financial education.
- In Charge: Dedicated to empowering consumers through personal financial management, In Charge provides online eBooks for educational purposes.

Key Principles of Financial Literacy for Mindful Entrepreneurs
EARN
SPEND
SAVE & INVEST
BORROW
PROTECT

The Four Pillars of Financial Literacy

1. Debt
Debt is money you spend that isn't yours. If you borrow money from the bank, use a credit card, or take out a short-term loan, or a payday loan, you are accumulating debt.
While debt is viewed negatively, for most people, it is necessary because only the extraordinarily wealthy can afford to pay for a house, car, or education with cash. The first lesson here, is to understand the difference between good debt and bad debt and to avoid bad debt as far as possible.
Good debt is considered money borrowed for things that are absolutely necessary for making a life e.g. a house and for advancing your money-making potential e.g. an education.
Bad debt is considered borrowing money or using a credit card to pay for things you don't need, such as expensive clothes, hi-tech electronics, eating out at restaurants, going on holidays, etc.

2. Saving
Saving is an essential part of financial wellness, a secure present, and a happy future. Wealth is built through spending less of your income so that you can achieve the following:
Realise important goals, whether it's to send your kids to university, fully paying off the loan on your home, and/or enjoying your retirement.
An emergency fund to cope with life's curveballs, such as home or car repairs, illness, or unemployment. This should be about three to five months' worth of income.
Treat yourself every now and then to the things you really want, such as an overseas holiday or a new sound system. Putting your savings into an interest-yielding bank account not only keeps your money safe, and out of temptation's reach, but also allows you to grow it over time.

3.Budgeting
Budgeting is the life skill of planning and managing your money. By understanding exactly where your money goes every month, you are empowered to create an actionable plan by which you can spend less, by curtailing those unnecessary expenses and saving more for the things you need and want.
The rule here is that money coming in (your total income) should always be greater than money going out (your total expenses). The difference between the two values is what you should be stashing away as savings.
Budgeting helps you plan for short, medium, and long-term expenses, enabling you to save accordingly to afford all three. It is, therefore, entirely necessary for financial security and independence.

4. Investing
Investing is all about creating and growing the wealth you need to enjoy a financially secure and happy future. It's about putting your money into something that will make you a profit over time, such as property, retirement funds, and unit trusts.
The growth of your investment's value can establish a second, monthly income for you, or, if and when you sell it, you'll have more money than you originally invested. The funds generated by your investments can then be used to see to your financial needs now and when you retire.

Example of Financial Literacy
Emma is a high school teacher who tries to inform her students about financial literacy through her curriculum. She educates them on the basics of a variety of financial topics, such as personal budgeting, debt management, saving for college and retirement, insurance, investing, and even tax planning. Emma's students can and will use these concepts for things like renting an apartment, getting a first job, or even just paying for fun activities such as going to the movies.
Understanding concepts such as credit cards, bank accounts, interest rates, opportunity costs, debt management, compound interest, and budgets, for

example, could help her students start saving and manage the student loans that they might rely on to fund their college education. It could keep them from amassing dangerous levels of debt and threatening their credit scores. Similarly, she expects that certain topics, such as income taxes and retirement planning, will eventually prove useful to all students, no matter what they end up doing after high school.

SAVING BEHAVIOUR

Saving behaviour refers to the financial decisions that households make about how to allocate their income between consumption and saving. Saving is the portion of income that is not spent on current needs, but instead set aside for future use.

Factors that can affect saving behaviour include:

- Financial literacy: A person's financial literacy can affect their saving behaviour.
- Financial management skills: A person's financial management skills can affect their saving behaviour.
- Self-control: A person's self-control can affect their saving behaviour.
- Saving horizon: A longer saving horizon can increase the likelihood of saving.
- Perceived subjective norms: A person's perceived subjective norms can affect their likelihood of having a savings account.
- Risk tolerance: A person's risk tolerance can affect their retirement financial planning behaviour.
- Parental socialization: A person's parental socialization can affect their saving behaviour.
- Family background: A person's family background can affect their saving behaviour.
- Self-dominance: A person's self-dominance can affect their saving behaviour.

Saving behaviour is a complex phenomenon that is influenced by a variety of factors, including psychological, behavioural, and situational aspects. Some theories and factors that may influence saving behaviour include:

- The savings process

The savings process typically involves three stages: planning, initiation, and habit-formation. In the planning stage, individuals set goals for saving, such as for emergencies or retirement. In the initiation stage, individuals make their first deposit towards a savings goal. In the habit-formation stage, individuals consistently set aside a portion of their income to save.

- Genetic predisposition

Some research suggests that genetic differences may explain a portion of the variation in savings behavior.

- Parenting

Parenting may contribute to savings rates in younger individuals, but its effect may diminish over time.

- Environment

The environment in which an individual grows up may moderate the genetic effects on savings behavior.

- Life experiences

Individual life experiences may be a significant factor in savings behavior, especially in urban communities.

- Personal wealth

The accumulation of assets a person owns may affect their savings rate.

- Income

Individuals with higher-than-average incomes may tend to save more.

- The theory of planned behavior

The theory of planned behavior (TPB) suggests that attitudes, subjective norms, and perceived behavioral control may affect intentions towards saving.