HOW FAR FINANCIAL LITERACY IS REQUIRED FOR OPTIMAL INVESTMENT BEHAVIOUR?

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ABSTRACT

Economic development of the nation depends upon the financial well being of its countrymen and for being financially sound, everyone wants one's wealth to appreciate. Wealth can be appreciated if the available money is invested in most appropriate avenues and the choice of such avenues need experience, guidance and financial awareness. In the present paper, I provide a comprehensive analysis of research that has studied the impact of financial education or financial literacy on investment behaviour. Many researchers have found a positive relationship between financial literacy and multiple financial activities i.e. savings, investments, credit card management, cash flow management etc. In the light of literature reviewed, I recommend to plan and execute financial education programs by targeting a specific audience and area of financial activity and also to evaluate such programs effectively for further improved programs in future.

Keywords: Financial Education, Financial Knowledge, Financial Literacy, Investors, Investment Behaviour.

Introduction

"Education isn't what you learn; it's what you do with what you learn"

Education means learning, in which the knowledge, skills and habits of group of people are transferred from one generation to the next through teaching, training or research. It's not just about what we are learning, but also how we are using our knowledge and skills in practical life. Education makes us aware of everything surrounded. It develops our personality, enables us understand and analyze the issues affecting our society and economy. It makes us aware of our health, our rights and our social responsibilities. More educated people become more democratic. Not just in our economic life but also in our social life, education guides us towards right and better path. Education develops our career at works places and makes our status in society. Whatever field of education we are opting, it will repay us during our lifetime.

Financial Literacy

PACFL provides a "consensus" definition The President's Advisory Council on Financial Literacy convened to "improve financial literacy among all Americans," defines financial literacy and financial education as follows:

Financial literacy: the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being.

Financial education: the process by which people improve their understanding of financial products, services and concepts, so they are empowered to make informed choices, avoid pitfalls, know where to go for help and take other actions to improve their present and long-term financial well-being.

Financial literacy is the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources. It is the ability to understand how money works in the world, how someone manages to earn on make it, how that person manages it, how he/she invest it and how that person donates it to help others. Financial literacy can be acquired either by practicing or by studying the fundamentals, theories and processes of business at several levels such as higher education, secondary education or university education. It covers the areas of accounting, marketing & finance and operations management.

Investment Behaviour

Investment behavior is the study of all activities of individual investors regarding allocation of surplus financial resources into various investment avenues. It reveals why individuals invest, where & how they get information, what factors they consider & evaluate while making investment, which factors influence their choice of investment , how they react after making investments etc. Behavioral finance helps us to study the investment behavior of investors by focusing on how investors interpret & act on micro & macro information to make investment decisions. With the aim of maximizing return on investment, investors try to reduce their risk associated with investments by constructing a portfolio of investment. By diversifying one's funds into a combination of more risky and less risky investment options, investors try to maximize their return at minimum risk. But every investor has different perception towards risk, some are risk taker and others are risk averse depending upon their demographic attributes which make them behave differently while making investments. Behavioral finance is helpful in explaining the different investment behaviors of investors and reasons of their behavior.

Review of Literature

Hilgert and Beverly (2003) explored the importance of the relationship between financial knowledge and behaviour by focusing on four categories of financial practices: cash flow management, credit management, savings & investments and found a positive correlation between financial knowledge and financial practices in a specific area. **Hogarth et al (2003)** explored the patterns of U.S. households' behaviour towards cash flow management, savings & investments and their learning preferences and found that financial knowledge and financial learning experiences being most consistent influencing valuable for financial behaviour of households. **Lusardi (2005)** found that only African-Americans were affected by financial education programs while the behaviour of Hispanics seemed to be unaffected by these programs and the reasons for this different behaviour were observed to be lack of information and low literacy. **Perry and Morris (2005)** examined the relationship between consumer financial knowledge, income and locus of control on financial behaviour and a negative relationship of external LOC with financial knowledge and responsible financial management behaviour. **Fu (2006)** examined the Taiwan Stock Market investors' perceptions of financial information transparency dimensions, investors' demographics and investors' experiences as significant explanatory variables of investors' behaviour and found that ownership structure financial transparency and board structure were significant explanation variable of investors' behaviour. **Lyons et al (2006)** examined the association between total number of financial education lessons completed, previous financial experiences and improvement in individuals' financial behaviour and observed a strong association between financial education and financial behaviour resulting into improvement in financial behaviour. **Peng et al (2007)** investigated the impact of personal financial education delivered in high school and college courses by measuring investment knowledge and household saving rates, years after the financial knowledge was delivered and found no significant relationship between taking a high school course and investment knowledge but noticed a positive association between financial experiences and saving rates. **Hathaway and Khatiwada (2008)** found that financial knowledge actually lead to better financial behaviour and suggested that future programs should be focused on a specific audience and area of financial activity. **Howlett et al (2008)** examined the potential explanations of why consumers behave differently in making personal financial decisions and found that self regulatory state had a significant influence on retirement investments. **Joan et al (2008)** investigated the association between financial behaviour and sources of financial information; association between savings and investing knowledge and financial information sources and the association between financial behaviour and saving and investing knowledge. They observed the importance and effectiveness of parents in teaching their children about personal finance. **Rebecca et al (2008)** investigated the success of program in impacting financial management behaviour and found the positive influence of programs on financial management of non-whites in terms of recording transactions and communicating with financial institutions. **Mandell and Klein (2009)** in their study found that those who take the course in Personal Financial Management were no more financially literate than those who had not and also discovered that students having course in Personal Financial Management did not evaluate themselves to be more savings-oriented and didn't appear to have better financial behavior than those who had not taken the course, hence raised serious questions about the long-term effectiveness of high school financial literacy courses. **Wang (2009)** studied the relation between the knowledge of male investors & female investors and risk taking behaviour and observed that the female investors had less objective knowledge & subjective knowledge than male investors and they took less risk and concluded with investors' subjective knowledge as the mediator between objective knowledge & risk taking**. Xiao et al (2010)** examined associations among financial education, financial knowledge and risky credit behavior of college students and focused on potential impact of financial education on risky credit behavior among college students. They found a positive relation between subjective financial knowledge and personal finance courses and concluded that objective credit knowledge reduced the likelihood of engaging in both risky paying and borrowing behaviors whereas subjective financial knowledge reduced the chance of engaging in risky paying behavior only. **Cliff (2011)** examined relationship between financial knowledge and credit card behavior of college students and his findings evidenced financial knowledge being a significant factor in the credit card decisions of college students who were benefited greatly from enhanced financial knowledge in the form of generally more responsible credit card behavior. **Cliff and Woodyard (2011)** examined the relationship between personal financial knowledge (both objective & subjective), financial satisfaction & selected demographic variables in terms of best practice financial behavior and found that subjective financial knowledge has a great influence on financial behavior. **Cavezzali et al (2012)** investigated the influence of financial literacy of individuals on their risk taking decisions and diversification behavior and found that financial literacy positively affects the risk taking decisions of individuals but less significant in explaining more sophisticated diversification strategies. **Cole et al (2012)** provided precise and causal estimates of the effect of education on financial market participation and financial management. . They found that the probability of financial market participation was increased by 7-8 percentage points with an additional year of education and also observed education being the most important reason in credit scores and reduction in the probability of declining bankruptcy or suffering foreclosure during the financial crisis.

Conclusion

In the above reviewed literature, it was observed that financial education, financial knowledge and financial literacy have a positive relationship with financial behavior and various financial activities. Those investors who are financially literate, either by studying financial education as their course in degree or by attending financial education programs reported a responsible financial management behaviour than the financially illiterate investors. Financial education, financial literacy and financial knowledge were noticed to be significant explanatory variables of investors' financial behaviour. The young investors, the college students who have opted for personal financial education programs or who have acquired financial knowledge, evidenced the financial knowledge being a significant factor in credit card decisions and such students were benefitted greatly from enhanced financial knowledge and more responsible credit card behaviour.

The available literature favored the financial education, financial knowledge and financial literacy as significant variables in the financial behaviour and also found the effectiveness of financial education programs in financial behaviour of individuals. On the basis of the literature reviewed, I recommend few suggestions to get the improved financial behaviour of the countrymen to ensure the acceleration of Nation's economy:- (1) To make investors aware about the usefulness of financial education, financial knowledge and financial literacy in their financial behaviour and to motivate them to acquire financial literacy. (2) To design more financial education programs with main emphasis on specific audience and financial activity that is whether household financial management, financial counseling, credit card behaviour etc. (3) To make financial education program evaluation as an integral part of such programs to ensure the effectiveness of such programs.

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