The importance of financial literacy in a global economic era

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Keywords
Financial literacy, financial planning, developed country

Abstract

This paper aims to explain a phenomenon in the financial sector, known as Financial Literacy. Financial literacy is a basic need for every individual to avoid financial problems. Financial difficulties occur not only due to low income only, financial difficulties can also occur if there are errors in financial management such as lack of financial planning or misuse of credit. The increasing financial literacy in many developed countries, it makes sense that the importance of the level of financial knowledge for us. In some countries, financial literacy has been proclaimed into a national program. The results of the study generally illustrate that the low level of financial literacy in developed countries, especially in developing countries. This condition becomes a serious problem because financial literacy has a positive effect on inclusion and financial behavior.

Background

Implementation of education in improving the understanding of finance in the community is necessary. With the rapid development and economic growth, financial institutions have an important role in life in the wider community. With the existence of various financial institutions that make every institution makes every effort to distribute various financial products and services to the community as a whole. In order for the public to be able to determine the products and services that are appropriate to the needs, the public must properly understand the benefits and risks, know the rights and obligations and believe that the selected financial products and services can improve the welfare of the community.

With a sizeable population, Indonesia must be able to prepare itself in the face of global competition in the era of MEA. One way of dealing with finances is how the individual controls his personal financial expenses. When continuous and unlimited expenditures result in individuals being difficult or incapable of controlling finances, this indicates that the individual has a poor level of financial literacy.

Financial literacy is closely related to the well-being of the individual. Financial knowledge and skills in managing personal finance are very important in everyday life. Financial difficulties are not just a function of income only (low income). Financial difficulties may also arise in the event of a mismanagement such as misuse of credit, and the absence of financial planning. Financial limitations can cause stress, and low self-esteem. The existence of financial knowledge and financial literacy will help the individual in managing personal financial planning, so that individuals can maximize the value of money and the benefits obtained by individuals will be greater and improve the life standard.

Financial literacy can be interpreted as financial knowledge, which aims to achieve prosperity (Lusardi and Mitchell, 2007). A good understanding of financial management is the way out of various problems, including reducing poverty. The higher the financial literacy the higher impact to the welfare. Knowledge and understanding of personal finance requires individuals to be able to make the right decisions in finance, so it is absolutely necessary for everyone to optimally use the right instruments and financial products. Lack of knowledge on financial literacy becomes a serious problem and becomes a big challenge for the people in Indonesia. Financial education is a long process encouraging individuals to have financial plans in the future in order to get prosperity in accordance with their lifestyle (Mendari and Kewal, 2013).

Financial literacy is a basic need for everyone to avoid financial problems. Financial difficulties may arise in the event of mismanagement. Having financial literacy is the most important thing to gain a prosperous life. With proper financial management supported by good financial literacy, the standard of living of the people is expected to increase, because no matter how high a person's income level but without proper financial management, financial security will be difficult to achieve. The need for public education on financial products of banks and non-banks is urgent so that people are not easily cheated by any irresponsible parties. The importance of financial literacy in all aspects of personal finance is not due to the difficulty in using the money they have, but individuals is expected to be able to enjoy their life by using their precisely owned financial resources.

Howell (1993) in Zahroh and Pangestuti (2014) states that personal finance management is one of the most fundamental competencies needed by modern society, because day-to-day consumer choices will affect a person's financial security and living standards. Problems in managing personal finances are often underestimated, so people tend to learn about personal finances through the process of trial and error.

In addition to benefits for individuals and communities, financial literacy is also needed to advance the financial services industry because the community is a major user of financial services. Financial literacy will create a chain effect on the level of use of financial products and services, which can then increase profits and encourage financial institutions to innovate in developing more varied financial products and services.

According to Gitman (2004), personal financial management is the art and science of managing the financial resources of individual units. Thus, personal financial management includes two elements of financial knowledge and art in managing. Why art in managing becomes something important too? Because managing activities require discipline and determine priorities derived from self-control. Self-control will help you to stay on the principle of management, such as efficiency and effectiveness. Efficiency, is using resources of funds optimally for the achievement of personal financial management goals. While effectiveness refers to the management of personal finance toward the right goal.

Literature review

Definition of Financial Literacy

Finance is an important aspect inherent in people's lives. Owned financial knowledge can help individuals in determining decisions in determining financial products that can optimize financial decisions. Knowledge of finance becomes very important for individuals to make no mistake in making financial decisions later (Margaretha and Pambudhi, 2015). If knowledge of the financials that they have less, will lead to losses for the individual, both as a result of inflation or decline in economic conditions at home and abroad. Misconceptions cause many people to experience financial losses, as a result of wasteful spending and consumption, unwise in the use of credit cards, and calculate the difference between consumer loans and bank loans. In addition, lack of knowledge about finances causes a person difficult to make an investment or access to financial markets.

Lusardi and Mitchell (2014) states that financial literacy consists of a number of financial skills and knowledge possessed by a person to be able to manage or use a certain amount of money to improve his standard of living and aim to achieve prosperity. Financial literacy is strongly associated with the behavior, habits and influence of external factors. Meanwhile, Chen and Volpe (1998) interpret financial literacy as knowledge to manage finances in order to live more prosperous in the future. Based on PISA 2012: Financial Literacy Assessment Framework (OECD INFE, 2012) it is formulated that financial literacy is a fundamental factor for the growth of economic and financial stability. From a consumer's point of view, good financial literacy leads to a spending decision that puts quality first. This will result in a healthy industry competition and competition will put forward innovation in goods and services offered to consumers. In addition, with good financial literacy can also minimize the occurrence of wrong decisions on emerging economic and financial issues. From a financial service provider's perspective, good financial literacy will provide adequate information about the product as well as a risk understanding. Meanwhile, from the government's point of view, with good financial literacy in the community, the government can obtain maximum tax revenue for infrastructure development and public service facilities.

Financial literacy include the ability to discern financial choices, mambahas money and financial issues without discomfort, plan for the future, and respond competently to life events that affect everyday financial decisions, including events in the general economy. Financial literature occurs when an individual has a set of skills and abilities that can leverage existing resources to achieve goals. Financial literacy helps to improve the quality of financial services and contribute to the economic growth and development of a country. Increasing the complexity of the economy, individual needs and financial products, the individual must have financial literacy to manage his personal finances.

Learning process can be interpreted as individual knowledge to understand something Knowledge related to finance called financial literacy. (Lusardi and Mitchell, 2007) defines financial literacy as financial knowledge and ability to apply it (knowledge and ability) (monetery economic journal). Financial Literacy occurs when an individual is capable (literate) is someone who has a set of skills and abilities that make people able to utilize existing resources to achieve goals. Literacy is an important thing that must be had to achieve its goals.

The level of financial literacy finance from the standpoint of individual or family can have an impact on the ability to have a long-term savings that used to own the assets (such as land or a house), the fulfillment of higher education and retirement (pension) (Aribawa, 2016). Financial literacy is defined as a person's ability to acquire, understand and evaluate the relevant information for decision making by understanding the financial consequences arising (Mason and Wilson, 2000). Informed decisions are recognized as instruments for achieving expected results. Financial literacy only makes a person able to make decisions based on relevant information. Financial literacy does not guarantee that the right decision is made, because one does not always make decisions based on economic rationale (Mason and Wilson, 2000).

Research conducted by Navickas, et al. (2013) states that individual financial planning responsibilities need to be done as early as possible, since financial mismanagement will be very disadvantageous and difficult to fix in the future. The results of this study indicate a lack of financial knowledge that causes households unable to manage finances well, spending some money to buy something less necessary. This causes the deposit level to be low and the return on investment is low. Other conclusions from the study include a high level of awareness of financial literacy that positively impacts everyday decisions and encourages higher levels of savings that ultimately improve the quality of life in the long term.

According to Rohrke and Robinson (2000), financial literacy is the best way to teach consumers about the benefits of having relationships with financial institutions such as funding and credit, the ability to build positive finances. Meanwhile, according to Hailwood (2007) financial literacy will affect how people save, borrow, invest and manage finances. Furthermore, financial skills here also emphasize the ability to understand the basic concepts of economics and finance, so how to apply them appropriately.

Financial literacy is divided into four aspects consisting of basic financial knowledge, saving and borrowing, protection (insurance), and investment (Chen and Volpe, 1998). According to Zahriyan (2016), basic financial knowledge which includes expenditure, income, assets, debt, equity, and risk. This basic knowledge is usually associated with making decisions in investing or financing that can affect a person's behavior in managing money owned.

In terms of finance, this financial intelligence includes 4 aspects of how to get money, how to manage money, how to save money and how to use money. From this simple definition, we come to know that the majority of people are still struggling with how to make money, have not thought of three other aspects. Moreover, they are still struggling to get money that only one aspect of it. So we also know that why there are artists, sportsmen or other professions who in his rich glory can be poor in his old age because he just understood how to earn money and do not know correctly how to manage, store and use it.

Dimension Financial Literacy

Financial literacy includes several financial dimensions that must be mastered. Chen and Volpe (1998) mention several dimensions of financial literacy that include general knowledge of finance, savings and loans, insurance, and investment.

General knowledge of finance

According to Wagland and Taylor (2009), knowledge of finance includes personal financial knowledge, which is how to manage income and expenditure, and to understand basic financial concepts. Basic financial concepts include simple interest rate calculation, compound interest, inflation influence, opportunity cost, time value of money, liquidity of an asset, and others.

Savings and loans According to Garman and Forgue (2011), saving is the accumulation of excessive funds acquired by deliberately consuming less than income. In the selection of savings, there are six factors to consider (Kapoor, et al., 2004), ie:

Rate of return (percentage increase in savings),

Inflation (need to be considered with the rate of return because it can reduce purchasing power),

Tax considerations,

Liquidity (ease of withdrawing short-term funds without loss or burdened fees),

Security (whether there is protection against losing money if the bank is experiencing financial difficulties, and

Limitations and fees (delays in interest payments entered in the account and charging fees of a particular transaction for deposit withdrawal).

Insurance

According to Mehr and Cammack (1980), insurance is a tool to reduce financial risk, by collecting exposure units in sufficient quantities, to make individual losses predictable. Then, the foreseeable loss is uniformly shared by the merged.

Investment. According to Garman and Forgue (2011), investing is saving or placing money in order to work so it can generate more money. The way one often invests in investing is by putting money into securities including stocks, bonds and mutual funds, or by buying real estate.

Implementation of financial literacy in developed countries

Financial literacy in the United States is a concept that is increasingly recognized after the occurrence of financial recession in the country. The advance of the financial sector in the superpower is encouraging the emergence of various kinds of financial derivatives instruments. On the other hand, workers 'retirement plans are now more dependent on Defined Contribution, whose compensation depends on the money invested in the program participants' accounts and their investment performance (Lusardi and Mitchell, 2014). Not to mention the variety of other products such as student loans, mortgages, credit cards, and so forth. Thus, given the vast number of financial instruments available today, knowledge of financial management is not only required at the organizational level but also in individuals, so as to make complex financial decisions appropriately, both now and in the future.

The US financial recession is a very meaningful lesson. Financial deregulation by the US government, fraud committed by consultants and financial businesses with the goal of making the most profit by encouraging investors to invest money in unprofitable investments, shook up the US capital market in 2008 (Ferguson, 2010) . With globalization, the crisis is worldwide. Not only do Americans feel the impact, but also other countries whose economies depend on the US. The magnitude of the impact of the recession, making the idea of the importance of existing long-standing knowledge and financial decisions come to the fore and become an important concern for researchers.

Starting from an awareness of the importance of financial literacy to be grown from an early age, various non-governmental organizations in the United States have a practical financial education starting from the primary school level. The Junior Achievement program, which was founded in 1919 in addition to educating participants about entrepreneurship and job readiness, the non-profit organization also organizes financial literacy programs such as more than money for elementary school students and finance park for middle school and high school students (JA). Even the National Financial Educator Council (NFEC), a profit organization specializing in financial literacy education, has a curriculum devoted to Pre-Kindergarten students to college students and adults (NFEC). In essence, all these financial literacy programs aim to produce well-informed individuals who can make intelligent financial decisions in life, thereby improving their quality of life especially in finance.

Financial literacy is also growing rapidly in other parts of the world, such as in, Germany, Italy, Sweden, Netherlands, Japan and New Zealand (Lusardi and Mitchell, 2011). It is understood that the development of financial literacy has a positive impact on micro and macro-economic development, so the United States formed a separate organization for this area, such as International Network Financial Education and National Council on Economic Education. A good financial literacy will make smart consumers, able to sort goods, be able to manage finances well and plan for the future. Thus, the government will be easy to carry out economic policy, related to capital market, inflation and so on. When the government raises interest rates, people who know financial literacy will choose to save rather than invest. Consumers who understand financial literacy will be more intelligent in choosing and complaining.

Conditions and recommendations for financial literacy improvement in Indonesia

The development of financial literacy in Indonesia does not seem to be as fast as its development in the United States. However, the program initiative to increase the level of financial literacy has been started since 2013 by The Financial Services Authority/Otoritas Jasa Keuangan (OJK), realizing the low level of financial literacy based on OJK suvei conducted.

An important mission of the financial literacy program is to educate the financial community to the Indonesian people in order to manage the finances intelligently, so that the low knowledge of the financial industry can be overcome and people are not easily fooled by investment products that offer high profits in the short term without considering the risks. The need for public understanding of products and services offered by financial institutions, the national strategy of financial literacy proclaims three main pillars. First, put forward the educational program and national campaign of financial literacy. Second, in the form of strengthening of financial literacy infrastructure. Third, talk about the development of affordable financial products and services. The implementation of the three pillars is expected to realize the people of Indonesia who have a high level of financial literacy so that people can choose and utilize financial services products to improve welfare (OJK, 2013).

Through the initiative of the program of increasing the financial literacy level beginning in 2013 by the Financial Services Authority (OJK), shows the low level of financial literacy. Based on a survey conducted by OJK in 2013, the level of financial literacy of the Indonesian population is divided into four parts: 1) Well literate (21.84%), which has knowledge and belief about financial services institutions and financial services products, including features Benefits and risks, rights and obligations related to financial products and services, and have skills in using financial products and services; 2) Sufficient literate (75.69%), have knowledge and confidence about financial services institutions and financial products and services, including features , Benefits and risks, rights and obligations related to financial products and services, 3) Less literate (2.06%), knowledgeable only about financial services institutions, financial products and services, and 4) not literate (0.41%), Have no knowledge and confidence in financial services institutions and financial products and services, and lack the skills in using financial products and services.

In order to increase the financial literacy of the Indonesian population OJK has collaborated with several universities such as University of Indonesia, Gajah Mada University, Diponegoro University, and University of Muhammadiyah Malang which is planning to hold a financial thematic Working Lecture (KKN) thematic finance (Mohamad, 2014). Education on financial literacy is still dominated by the faculty of economics at universities in Indonesia.

Student empowerment is a widely practiced practice in developed countries in disseminating financial knowledge through student volunteer programs, such as Syracuse University with a student to student program, the George Washington School of Business holds opportunities for volunteers consisting of students, staff and alumni to Share financial knowledge both on and off campus, and the University of Nebraska-Lincoln Student Money Management Center also opens a student volunteer program to promote, write articles, teach, bulletin designers or become a social media ambassador on financial management.

Meanwhile, conditions in Indonesia, financial literacy research on the level of students is still very needed because it is still very rare. Therefore, OJK is expected to increase the cooperation with various universities in Indonesia to educate about financial literacy considering the large potential of students in improving financial literacy of the community.

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