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IMPACT OF FINANCIAL LITERACY ON PERSONAL FINANCIAL DECISION MAKING

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Abstract
Financial literacy plays a fundamental role in personal financial management, shielding individuals from the adverse effects of financial instability. This dissertation examines the relationship between financial literacy and household financial decision-making in developing countries. While financial hardship is often linked to low income, financial mismanagement-such as poor planning, overspending, or imprudent credit use-further aggravates these challenges. Despite the rise of financial literacy programs globally, developing nations continue to experience a significant literacy deficit.

This study evaluates how financial literacy influences saving behaviour, borrowing decisions, and overall financial preferences. Findings reveal that financial literacy has a strong positive impact on saving behaviour, shaping prudent financial habits. However, its effect on debt management appears comparatively weaker. Short-term interventions like workshops show temporary improvements, but long-term outcomes remain uncertain. Moreover, the relationship between financial literacy and household decisions varies widely across socio-demographic groups, highlighting the need for tailored policy strategies.

The dissertation underscores the urgency of addressing financial literacy gaps to improve consumer decision-making, promote financial inclusion, and safeguard consumer rights. Insights from this research can guide policymakers in crafting targeted interventions to strengthen household financial resilience, especially within vulnerable demographic segments.

Key Words: Financial Literacy, Household Behaviour, Socio-Demographic Factors, Financial Inclusion, Developing Countries.

Introduction

Financial literacy has gained immense relevance in recent years due to rapid financial innovation, digitalization, and expanding access to financial products. Although financial markets have become more inclusive, the 2008 Global Financial Crisis exposed substantial weaknesses in consumer financial awareness. Many individuals made risky decisions-especially through easy credit-without understanding their financial capacity, leading to severe economic consequences.

Early research highlighted a lack of academic clarity and standardized tools to measure financial literacy. However, following the crisis, measurement efforts expanded significantly at both national and international levels. Financial literacy is now widely recognized as an essential prerequisite for financial inclusion, enabling individuals to make informed decisions, manage financial risks, and engage efficiently with financial institutions.

In developing countries, structural challenges such as poverty, unemployment, and limited financial infrastructure further exacerbate financial vulnerability. Understanding how consumers behave in

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such environments is crucial. Although evidence suggests a strong link between financial literacy and financial well-being, empirical studies-especially from under-researched regions-remain limited.

This dissertation addresses this gap by examining how financial literacy affects consumer decision-making in developing nations. It also explores how socio-demographic characteristics such as gender, age, education, and income influence financial literacy and financial outcomes. The research contributes to policy discussions on financial stability, inclusion, and consumer protection.

Objectives of the Study

The primary aim of this dissertation is to understand the impact of financial literacy on consumer financial behaviour in developing countries. The specific objectives include:

1. To measure current levels of financial literacy among consumers in selected low-income or developing economies.
2. To identify socio-demographic factors—such as gender, age, income, and education—that influence financial literacy.
3. To examine how financial literacy affects financial decisions, including saving, borrowing, and investment behaviour.
4. To provide policy recommendations for improving financial inclusion, consumer protection, and long-term financial stability.

The Concept of Financial Literacy

Financial literacy is a relatively new but rapidly expanding concept in academic literature. The earliest documented definition (1992, NatWest Bank) describes it as the knowledge and skills needed to manage financial resources effectively. The JumpStart Coalition defines it as "the ability to use financial knowledge and skills to achieve long-term financial security." Many scholars emphasize that financial literacy is not limited to knowledge alone but includes behaviours, attitudes, and practical decision-making skills.

Financial knowledge is essential because finance influences nearly all aspects of life. Individuals with strong financial understanding can evaluate financial products, manage risks, and make informed decisions regarding saving, borrowing, and investing. In contrast, poor financial literacy can lead to overspending, excessive debt, misuse of credit, and failure to participate in financial markets.

Studies highlight that early financial education is crucial, as delaying financial planning can have long-term negative effects. Research shows that households with low financial literacy often engage in poor financial management, resulting in low savings, inefficient borrowing, and reduced returns on assets. Conversely, higher financial literacy improves engagement with financial institutions, enhances access to credit, and supports wealth accumulation.

Financial Literacy in Developed Countries

In developed nations such as the United States, Germany, Italy, Sweden, Japan, and New Zealand, financial literacy has become increasingly important due to complex financial products and changing retirement systems. With the growth of defined contribution pension schemes, individuals must now manage their own retirement savings—a task requiring financial competence.

The 2008 crisis further reinforced the need for financial literacy. Deregulation, misleading financial advice, and irresponsible borrowing played major roles in the crisis, demonstrating the consequences

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of poor financial decision-making. As a result, many developed nations introduced large-scale financial education programs.

Non-governmental organizations like Junior Achievement, National Financial Educators Council, and many school-based initiatives promote financial literacy from early childhood through adulthood. These programs aim to equip individuals with skills for budgeting, saving, investing, and handling credit responsibly.

International evidence shows that financially educated citizens are better prepared to manage money, plan for the future, and cope with economic shocks. Governments also find that financial literacy supports the effective implementation of monetary and fiscal policies.

Financial Literacy, Socio-Demographics, and Financial Decisions

After the 2008 crisis, research began to focus on the relationship between financial literacy, economic stability, and household financial choices. Financial literacy significantly affects decisions related to saving, borrowing, investment, and retirement planning. Groups such as women, minorities, low-income individuals, and less-educated populations often exhibit lower levels of financial literacy, influencing their financial stability.

Financially literate individuals are more likely to invest in stock markets, accumulate wealth, and manage debt efficiently. Poor financial literacy is closely associated with excessive debt, inefficient borrowing, and susceptibility to financial fraud. Social-demographic factors—including education, employment, income, age, and gender—play a significant role in shaping financial knowledge.

Although parents influence young people’s financial attitudes, many do not actively teach financial management skills. Addressing these demographic disparities is essential for achieving equitable financial well-being and national development.

Measurement of Financial Literacy in Developing Countries

Measuring financial literacy in developing countries requires context-specific tools that reflect local cultural, economic, and educational realities. Common approaches include:

1. Survey-Based Approaches

Used by the OECD, World Bank, and national governments to assess:
financial knowledge
financial attitudes
financial behaviours
These tools face challenges such as language barriers, cultural bias, and low survey participation.

2. Qualitative Approaches

Focus groups and interviews provide deeper insights but lack scalability and comparability.

3. Hybrid Approaches

Some countries combine standardized international tools with local adaptations to ensure cultural relevance and global comparability.
Challenges include low literacy levels, limited financial access, and lack of awareness. However, mobile technology and partnerships with community organizations present promising opportunities for improving data accuracy and outreach.

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International Methodologies: Comparative Analysis

International organizations—including the OECD/INFE and the World Bank (RTF)—have developed financial literacy measurement tools. Each method possesses strengths and limitations:

1. OECD/INFE Method
2. Measures knowledge, attitudes, and behaviours
3. Enables global comparison
4. Lacks separation between knowledge and skills
5. May not capture local issues in developing countries
6. World Bank/RTF Method
7. Uses focus groups to identify local manifestations of financial capability
8. Covers planning, budgeting, decision-making and help-seeking behaviour
9. Provides rich qualitative information
10. May not align with national policy needs
11. Does not account sufficiently for education or income variation
12. Policy Implications
13. Countries should adopt context-specific methodologies that consider demographics, cultural factors, and financial infrastructure.
14. More global collaboration and harmonized survey tools are needed.
15. Financial literacy should be integrated into national development strategies.
16. Vulnerable groups—women, rural households, youth—should receive targeted financial education.

Research Methodology: This study examines the effect of financial literacy on consumer financial decisions using a predominantly quantitative approach. Some qualitative elements are incorporated to provide depth and contextual understanding.

Data Source: The research uses secondary data from the Consumer Banking Association's (CBA) 2014 Financial Literacy Assessment Survey. Secondary data offers the advantage of reliability, cost-effectiveness, and access to large samples.

Analytical Tools

1. Descriptive statistics to examine financial literacy levels
2. Cross-tabulations to assess relationships between: Age, gender, education, income financial literacy saving and borrowing behaviour.
3. The methodology provides a structured foundation for analysing how literacy levels influence household decisions and highlights socio-demographic disparities.

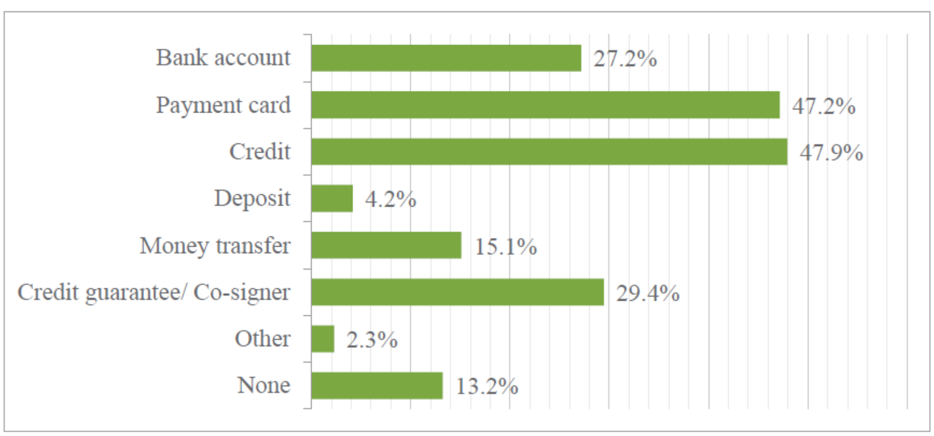

Fig 4.1 The use of financial services in treatment group

The analysis of the graph reveals that among workshop participants, loans and credit cards are the most frequently used financial services. A notable finding is that while 47% of participants have payment cards, only 27% report having a bank account. This suggests a fundamental misunderstanding, as payment cards typically require an associated bank account. Additionally, 34% of consigner's have no loans of their own, while 41% of those with loans also cosign for others—indicating a heightened risk of over-indebtedness. Despite seasonal worker migration, only 15% have used money transfer services, a figure that ideally should be higher. Furthermore, 13% of respondents do not use any financial services at all. This lack of engagement may stem from low trust in financial institutions, limited access to branches and ATMs, insufficient information, and poor financial literacy.

Using secondary data from the Consumer Banking Association (CBA), this study applies descriptive tools-such as measures of central tendency and dispersion—to summarize dataset features. Cross-tabulation is then used to examine relationships between variables such as income, age, gender, education, and financial behaviour, revealing how financial literacy differences shape consumer decisions.

Data Collection and Analysis

Data Collection

The CBA financial capability assessment uses face-to-face interviews with a detailed questionnaire comprising 118 questions, divided into eight sections covering respondent characteristics and seven thematic areas. The survey targets adults aged 18 and above, focusing on individuals rather than households to capture personal financial behaviour more accurately. Both urban and rural areas across the country are included to ensure national coverage.

Sample Size and Representation

With a sample of 1000 respondents, and a 95% confidence level with a 2.5% confidence interval, the study ensures national representativeness. Although the sample is not large enough to represent every subgroup with statistical precision, it provides strong indicators of financial literacy trends and commonly observed behavioural patterns across the population.

Analysis Approach

A combination of descriptive analysis and cross-tabulation is used to assess financial literacy levels and behavioural trends. This method identifies patterns across demographic and geographic groups and explores how factors such as income, gender, age, and education influence financial capability. By examining correlations between these variables, the study highlights key drivers of financial behaviour and areas requiring targeted interventions.

The careful use of secondary data and structured analytical methods enables the study to explore the determinants of financial capability and support the development of evidence-based strategies aimed at improving financial literacy nationwide.

Assessment of Financial Literacy Levels

Evaluating financial literacy in developing countries is vital, as financial knowledge shapes consumer decision-making and overall economic stability. Despite increased global awareness, many developing nations face significant challenges, including limited access to financial services, inadequate education systems, and widening inequalities. These barriers restrict individuals' ability to make informed financial decisions, thereby increasing vulnerability to financial shocks.

IJMSRR
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This study uses secondary sources to assess literacy levels across multiple developing nations, focusing on the core dimensions of financial literacy: knowledge, skills, attitudes, and behaviours. By reviewing existing studies and reports, the dissertation identifies common challenges such as low savings culture, limited understanding of credit, and minimal participation in investment markets. It also highlights successful practices in financial education, offering lessons for broader implementation.

At the same time, the CBA's primary data collection—including surveys and interviews—provides direct insights into financial behaviour. This allows for a nuanced understanding of demographic variations. Factors such as age, gender, education, and income significantly influence financial literacy levels, with disadvantaged groups generally showing lower literacy and weaker financial decision-making skills.

The findings hold substantial implications for policymakers and financial institutions. Understanding financial literacy gaps enables stakeholders to design targeted interventions, improve outreach efforts, and develop educational programs tailored to specific communities. Such initiatives can enhance consumer protection, promote ethical financial behaviour, and support long-term economic empowerment.

In conclusion, assessing financial literacy in developing countries is essential for promoting financial inclusion, reducing poverty, and strengthening economic resilience. By analysing the relationship between financial knowledge and consumer decision-making, this study contributes to ongoing efforts to improve financial well-being and support sustainable development across emerging economies.

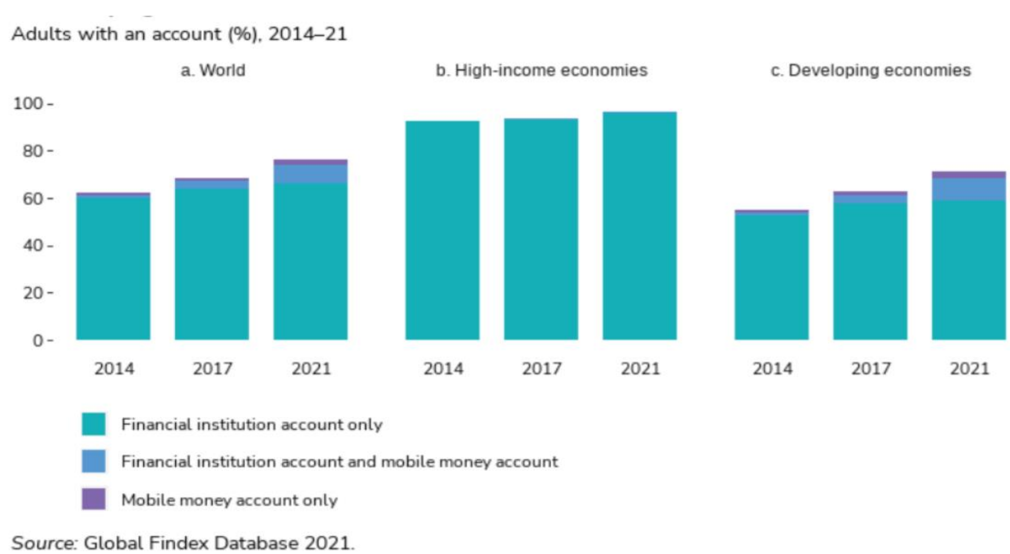

Fig.4.2 Rapid increase in account ownership

Quantitative Findings

Descriptive Statistics

The sample consisted of 1,000 adult respondents from selected low-income countries, with a balanced age and gender distribution (55% female, 45% male) and an average age of 34. Financial literacy levels were generally low: around 70% demonstrated basic knowledge, while only 25% showed proficiency in complex concepts.

IJMSRR
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Correlation and Regression Results

A moderate positive correlation was found between financial literacy and responsible financial behaviour ($r = 0.45$, $p < 0.01$). Regression analysis confirmed financial literacy as a significant predictor of financial outcomes.

Savings behaviour: $\beta = 0.35$, $p < 0.001$

Debt management: $\beta = -0.28$, $p < 0.01$

Higher financial literacy was associated with better saving patterns and fewer problems with high-interest debt.

Structural Equation Modelling (SEM)

SEM supported the theoretical framework: financial literacy had a direct, significant effect on financial decision-making (path coefficient = 0.40, $p < 0.001$) and indirectly improved financial well-being through positive financial behaviours such as budgeting, disciplined saving, and reduced reliance on costly loans.

Qualitative Findings

Barriers to Financial Literacy

Participants cited a lack of formal education, limited access to financial education resources, and cultural norms surrounding money management as major constraints. In some communities, traditional beliefs and gender roles restricted financial decision-making autonomy.

Sources of Informal Financial Learning

Peer groups, neighbourhood networks, and community leaders were important informal educators, particularly in rural areas. Many respondents used mobile phones and social media to learn about savings, credit, and money management, highlighting technology's growing role in informal financial education.

Financial Decision-Making Patterns

Individuals with higher financial literacy reported stronger savings habits, more cautious investment decisions, and more effective use of insurance and risk-management tools. Those with low literacy struggled with debt, frequently depending on high-interest lenders and facing repayment difficulties.

Conclusion

The study demonstrates that financial literacy in developing countries remains uneven and generally low, significantly influencing consumer financial decisions. Structural barriers such as limited access to financial education, socio-economic inequalities, and cultural constraints hinder individuals' ability to manage finances effectively. The findings show clear links between financial literacy and positive financial behaviours—particularly saving, investment, and responsible debt management. Demographic factors such as education, income, gender, and age shape financial knowledge, with women and low-income groups facing greater disadvantages.

The results emphasize the need for targeted policies, improved financial education programs, and expanded access to reliable financial services. Addressing demographic disparities and strengthening financial capability can support consumer protection, promote financial inclusion, and enhance economic resilience. Overall, the study highlights the urgent importance of improving financial literacy to empower households, reduce poverty, and support sustainable development in low-income and developing nations.

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