

TECHNICAL SUMMARY



Financial Literacy Around the World: An Overview of the Evidence with Practical Suggestions for the Way Forward

By Lisa Xu and Bilal Zia, World Bank Policy Research Working Paper No. 6107, Washington D.C.: World Bank 2012.



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Introduction

The following is a summary of Xu, L. and Zia, B. (2012). *Financial Literacy Around the World: An Overview of the Evidence with Practical Suggestions for the Way Forward* (World Bank Policy Research Working Paper No. 6107). Washington D.C: World Bank.

Financial literacy programs have become an important component of financial policy reform worldwide. To find out whether these programs are effective in achieving their objectives, the authors reviewed a number of empirical studies on financial education programs and their associated outcomes.

The review shows that high income and low income countries approach financial education differently. For example, in high-income countries, financial education focuses on preparing

individuals to navigate a wide range of financial products to make sound financial decisions.

In low-income countries, financial education focuses on increasing access to and take-up of financial services. In addition, enhancing business knowledge is an important focus of financial literacy programs in low income countries given that many individuals are entrepreneurs as opposed to wage-earners.

The State of Financial Literacy Worldwide

Financial literacy levels are low worldwide, especially in developing countries. Low levels of financial literacy are associated with negative financial outcomes.

There are four aspects that are common in both developed and developing countries:

- women rank lower in financial literacy than men
- financial literacy peaks in mid-life and is lowest among youth and seniors
- higher education and income levels are associated with greater financial literacy
- geographic and racial/ethnic differences in financial literacy are prevalent

In high-income countries, financial literacy is correlated with retirement planning and more sophisticated investment behavior. In addition,

financial literacy is shown to affect debt and mortgage outcomes as well as inflationary expectations.

In low-income countries, financial literacy is correlated with having a bank account, and is found to affect insurance take-up. In addition, business literacy in developing countries is low. For instance, in Zambia, the majority of micro, small, and medium enterprises (MSMEs) cannot access finance because of inadequate business records.

Effectiveness of Financial Literacy Programs

In order to understand their effectiveness, the authors reviewed existing evidence showing impacts of financial literacy program on consumers and entrepreneurs.

For Consumers

Consumer financial education programs typically focus on knowledge and awareness of financial products and financial planning. The results of consumer-side interventions in both high and low-income countries indicate that:

- **Promoting retirement planning can increase retirement savings.** Employer-provided education programs are associated with increased savings of employees. In addition, an individual's social group can influence retirement planning and the take-up of financial products.
- **Mortgage counseling (both mandatory and voluntary) can prevent mortgage delinquency.** The effects of voluntary counseling were greatest amongst the least creditworthy households. Mandatory counseling for “high-risk” applicants has been shown to reduce default rates by 30%.
- **Promoting savings among low-income individuals and minorities varies depending on the program.** Training urban low- and moderate-income individuals to use internet for financial services did not increase the use of online banking. Seminars, on the other hand, seem to lead to increased savings behavior. Innovative multi-media program formats, such as video games and Spanish-language “telenovelas” (soap operas), are increasingly employed in the United States and show promising results.
- **The effectiveness of student financial education is subject to debate, and varies depending on curriculum, student sample, and methodology.** Studies show, however, that financial education is more effective when tailored to the specific needs and goals of the students.
- **In low-income countries, the efficacy of interventions to improve access to finance and financial capability is unknown.** Studies are underway, though



the results are pending. Programs increasingly use inventive delivery formats. These include videos, radio, theater, and soap operas and employ mobile technology.

For Entrepreneurs

Until recently, evaluations of financial education programs for entrepreneurs were mostly restricted to high-income countries. The number of impact evaluations of such programs in developing countries has been increasing with the prevalent use of randomized control trials in development research.

The burgeoning body of research suggests that financial education for entrepreneurs or business training is recognized as an important intervention in developing countries. There are two primary reasons for this finding. First, many individuals in low-income countries earn an income from small enterprise. Second, managerial skills are shown to have a significant effect on a firm's production function, growth and productivity. Business training programs show promise to improve not only individual livelihoods but also economic growth. In low income countries, business training has the following effects:

- **Positive effects on business knowledge are widespread.** Male entrepreneurs and those with less formal education show the greatest increases in business knowledge.
- **Effects on business outcomes, however, vary greatly.** Multiple studies produce inconsistent impacts on business revenue,

profits, employment and firm entry/exit. Additional research is underway to improve the impact of financial education on business outcomes.

- **Gender plays an important role on business outcomes.** Studies suggest that women may be more cash-constrained than knowledge-constrained. In addition, female entrepreneurs are less likely to engage in competitive behavior, and face greater social limitations than male counterparts.
- **Simplified rule-of-thumb training generates positive effects on business practices and outcomes, whereas fundamentals-based accounting training does not.** This seems especially relevant for entrepreneurs who are time- or effort-constrained, and whose ability and attitudes are more similar to wage-earners than entrepreneurs.

Recommendations for Policymakers

Based on the analysis of financial literacy and education programs, the following recommendations are presented to improve future programs.

To improve financial education for Consumers:

- **Start with awareness**—A lack of knowledge of financial products is a major barrier to take-up.
- **Leverage social networks and peer influence**—Financial literacy interventions can yield positive spillover effects, a cost-effective method to spread information.
- **Identify and target vulnerable populations**—Women, youth, the elderly, and those with lower incomes and educational attainment are less likely to be financially literate.

- **Solicit specific topics of interest**—Motivation and perception of relevance influence participants' benefit from financial education.
- **Be creative with the delivery format**—Individuals of different geographic, socioeconomic, and cultural backgrounds may find certain formats more engaging or informative than others.
- **Implement complementary interventions and consider supply-side failures**—Financial education may not be as effective in increasing access as other interventions, such as subsidies. In some cases, irrelevant products and services may be the cause of low up-take.

To improve business training interventions for Entrepreneurs:

- **Identify gaps in business knowledge**—There is limited systematic survey evidence of the business literacy needs of entrepreneurs in developing countries. More studies are needed to tailor training programs for entrepreneurs.
- **Pay attention to the curriculum**—Financial education should be presented in simple terms, while recognizing that the saturation point of such interventions arrives quickly.
- **Take into account participant differences**—Customize business training programs to specific groups of entrepreneurs. Female entrepreneurs have often failed to benefit.
- **Complementary interventions may be needed**—Entrepreneurs can benefit from a mix of both subsidies and financial education.

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