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11. Financial Literacy and Planning for Retirement Wellbeing

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Abstract:

The reasons behind people's failure to save for retirement and the potential impact of planning and information expenses on retirement saving behaviors are relatively poorly understood. People now face several obstacles, including the need to carefully plan for their retirement due to changes in the employment market, increases in life expectancy, and improvements in the retirement savings market. Retirement planning requires financial literacy, especially in light of the vast diversity of long-term financial products, schemes, and services that are being pushed to individual investors. The subject of our study is "retirement literacy," or the understanding of finances in relation to retirement planning. The two facets of financial literacy that are surveyed and documented are financial knowledge and financial decision-making behavior. The findings show that retirees' financial well-being is greatly impacted by family support, retirement preparation, and financial literacy. More significantly, retirement planning and family support have a greater positive impact on retirees' financial wellbeing than does financial literacy. The results suggest that retirement planning and financial knowledge ought to be encouraged. In order to optimize seniors' financial well-being, it is also important to consider policies that support family values and foster social cohesion. We will talk about in this essay. Planning for retirement and financial literacy are important.

Keywords:

Financial Literacy, Planning, Retirement Wellbeing, Costs, Retirement Saving Patterns, Decision-Making, Family Support, Economic Entities, Investment, Life-Cycle, Interest Rates, Big Three.

11.1 Financial Literacy:

In general, the problem of financial literacy emerged to gauge different economic entities'—especially individuals'—capacity to make financial decisions. Different definitions of the term can be found in the academic literature, as we indicated in the paper's introduction. In the literature, the idea of financial literacy is well-established. Financial literacy generally refers to a person's comprehension of and proficiency with a variety of financial abilities. Financial literacy and household financial behavior, such as saving, investing, and retirement planning, are closely related, as numerous studies have clearly shown. Respondents are frequently asked three questions covering basic economics and finance topics, such as basic computations regarding interest rates, inflation, and risk diversification, in order to assess their level of financial literacy. It has been discovered that financial literacy influences household and individual financial decision-making. This is mostly due to the fact that making financial decisions involving the purchase of assets or the management of debt necessitates basic math skills and comprehension. Financial literacy levels have been reported in surveys all around the world, but studies have consistently connected financial literacy to financial decisions made at home. Financial literacy has been demonstrated to influence judgments concerning household debt, entrepreneurship, and financial investments in addition to retirement planning and saving. [1]

Retirement Strategy Retirement financing adequacy can be achieved with the help of retirement planning, which is the process of preparing for the time when income from employment will stop. Retirement planning also entails planning and judgments on how limited financial resources should be allocated to maximize their usage later on, thus it may be viewed as both a process and an action.

Retirement planning is the process of putting plans in place to give people a source of income after they retire and are no longer able to rely on a consistent source of income from work. Higher levels of financial resources in retirement are the product of effective retirement planning, and these higher levels of resources will help people feel in charge of their financial situation, feel secure and independent, and maximize their wealth over time. It is imperative to make retirement plans as soon as feasible in order to guarantee one's financial security in retirement.

Nevertheless, very few people plan for their retirement. Retirement planning, then, is the process by which people determine how much of their income to save for retirement and when to start saving. Thus, people might lessen the chance that they won't have enough money for retirement by making retirement plans. It is stressed that retirement planning is not a required task. [2] People must, however, decide to plan ahead financially and make sure their money is handled appropriately. Retirement planning and enough money for retirement are therefore related.

Researchers have shown an interest in the financial or economic well-being of retirees. The problem is particularly apparent in developing nations because pension payouts are insufficient to cover recipients' basic needs.

The cornerstone of smart retirement planning is financial knowledge. It includes all of the information and abilities required to make wise financial decisions throughout one's life. Being financially educated gives people the tools they need to safeguard their future, from knowing the fundamentals of saving and budgeting to navigating complex investment alternatives.

Evaluating your existing financial status is one of the first steps in retirement planning. Taking stock of your possessions, debts, earnings, and outlays is necessary for this. Knowing where you are at this point can help you create a realistic plan for reaching your retirement objectives. When calculating the amount of money, you'll need to save in order to maintain your ideal lifestyle in retirement, tools like retirement calculators can be quite helpful. [3]

11.2 Review of Literature:

Since more people are taking greater responsibility for their retirement these days, financial literacy is essential for those who want to prepare for retirement. Previous research has examined the reasons behind people's under-saving or under-planning for retirement and has discovered a significant correlation between people's retirement planning practices and their financial literacy. Previous research has shown that in many countries, those who are objectively less financially knowledgeable save less for retirement and accumulate less retirement wealth (Behrman et al. 2012;) [4]

According to Lusardi (2010), a third of persons in their 50s have not developed any sort of retirement savings plan, and the majority of older Americans lack confidence in the effectiveness of their attempts to save for retirement. Why is there such a low level of retirement readiness? What causes people to perform so poorly when it comes to creating and implementing retirement savings plans? In this essay, we investigate the theory that financial illiteracy may be the main cause of inadequate planning. To put it another way, we assess whether those who claim they are unable to save for retirement or to plan for it are also the ones who lack the most basic understanding of the economic principles that underpin financial well-being throughout life. [5]

Conversely, a person who is in a state of financial well-being is one who is able to make decisions that allow them to enjoy life, feels confident about their financial future, and can completely satisfy their current and ongoing obligations (OECD, 2015).

It consists of four components: being able to absorb financial shock, feeling in control of your finances, being on pace to meet your financial goals, and having the freedom to make decisions that let you enjoy life. High financial well-being gives people the financial flexibility to make decisions that enhance their quality of life.

This flexibility is treating yourself to a trip or occasionally indulging and spending money on wants rather than necessities. Retirees who have little income in the face of skyrocketing living expenses should make wise financial decisions because their income will fall and they will need to understand the life-cycle theory of consumption and savings, which promotes financial literacy. The life-cycle model's most basic explanation advocates for smoothing consumption, maximizing lifetime utility, and making decisions in the face of uncertainty. The fundamental predictions of the life-cycle theory are predicated on the notions that people are logical, forward-thinking, and well-informed about the numerous variables that affect wealth growth. [6]

As people progress through their life cycles, they encounter an increasingly complex economic and financial world. Globally, people must increasingly bear a larger portion of the cost of their future retirement savings as well as their medical and long-term care expenses due to reductions in the scope and generosity of governmental programs. The quantity and complexity of financial goods are also rising. The knowledge of deferred values, interest rates, the impact of inflation, survival probabilities, and other concepts is necessary in this situation to provide proper financial security as one ages. Mitchell (2008). [7]

11.3 Objectives:

- Call for increasing individual's responsibility in designing retirement strategies.
- To understand the importance of financial literacy for the economic wellbeing of the nation.
- To study the effect of financial literacy on accessing the personal financial planning services
- 'Big Three' financial literacy.

11.4 Research Methodology:

This study's overall design was exploratory. The research paper is an endeavor that is founded on secondary data that was obtained from reliable online resources, newspapers, textbooks, journals, and publications. The research design of the study is mostly descriptive in nature. The secondary data that demonstrates financial literacy and retirement wellbeing planning forms the basis of this paper in its entirety.

11.5 Result and Discussion:

Once again, families and policymakers are focused on the issue of global inflation, which is putting pressure on people's finances, eroding their saving habits, and endangering their long-term financial stability.

This column looks at how much people's financial decision-making is influenced by their level of financial literacy, particularly their understanding of inflation. With potentially long-lasting effects, consumers in the modern economy are faced with a wide range of complex financial decisions.

The proliferation of online financial apps for borrowing and investing, the recent increase in inflation, the availability of new asset kinds (like cryptocurrency), new payment methods (like "buy now, pay later"), and new means to make payments have all increased the demand for financial literacy. Sadly, an overwhelming amount of data suggests that people's choices frequently put them in debt and financial hardship.

11.5.1 Measuring Financial Literacy:

We chose to look into patterns of financial literacy in the early 2000s because of this, as well as after observing changes in pensions and credit availability. Financial literacy is defined as people's understanding of and capacity to apply fundamental financial concepts in their daily financial decision-making (Lusardi and Mitchell 2014).

The outcome of this endeavor is what has come to be referred to as the "Big Three"—a brief series of inquiries that serve as incredibly helpful gauges of people's comprehension of fundamental financial ideas (Lusardi and Mitchell 2011). The most current information from a nationwide poll on consumer finances is used to list these questions and their responses in Table 1. [8]

Table 11.1 The 'Big Three' Financial Literacy Questions and Answers [9]

1) Suppose you had $100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?

    More than $102**
    Exactly $102
    Less than $102
    Do not know/Refuse to answer

2) Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account?

    More than today
    Exactly the same
    Less than today**
    Do not know/Refuse to answer

3) Please tell me whether this statement is true or false. "Buying a single company's stock usually provides a safer return than a stock mutual fund."

    True
    False**
    Do not know/Refuse to answer

Even among older individuals who have made many financial decisions in their lifetime, less than half of those questioned in this nationally representative US survey correctly answered all three of the questions, despite the fact that the purpose of the survey was to evaluate knowledge of the fundamentals of personal finance (Figure 1). Our Big Three contains a question regarding inflation, which is a current economic hot topic. We have discovered that a significant portion of the public, particularly the younger generation, is unaware of how inflation reduces purchasing power. [10]

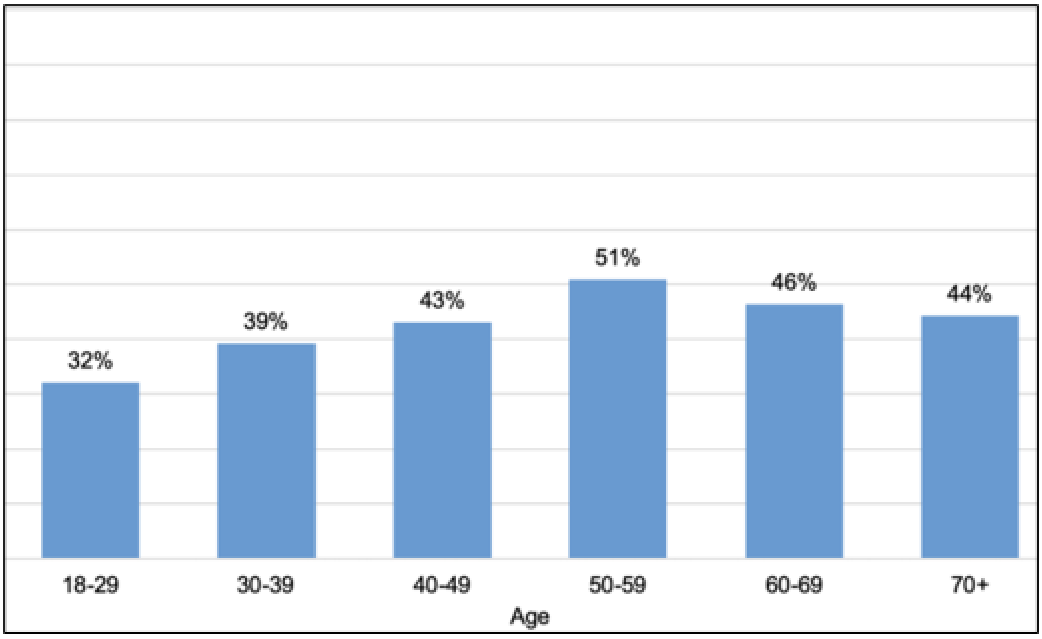

Figure 11.1: Percent of Respondents Answering All Big Three Questions Correctly (Source: Authors' calculation, US Survey of Consumer Finances (2019). [11]

Figure 11.1: Age-specific percentage of respondents who properly answered all three Big Three questions Figure 11.2 shows that most rich countries also exhibit similar patterns for the Big Three, and people's knowledge of developing economies is significantly lower (Lusardi and Mitchell 2014). Furthermore, there is a notable cross-national similarity among the less financially similar groups.

That is, financial literacy is low among young people, women, low-income and less educated people, and members of racial or ethnic minorities, which makes them even more vulnerable financially than would be expected based on other conventional indicators like savings.

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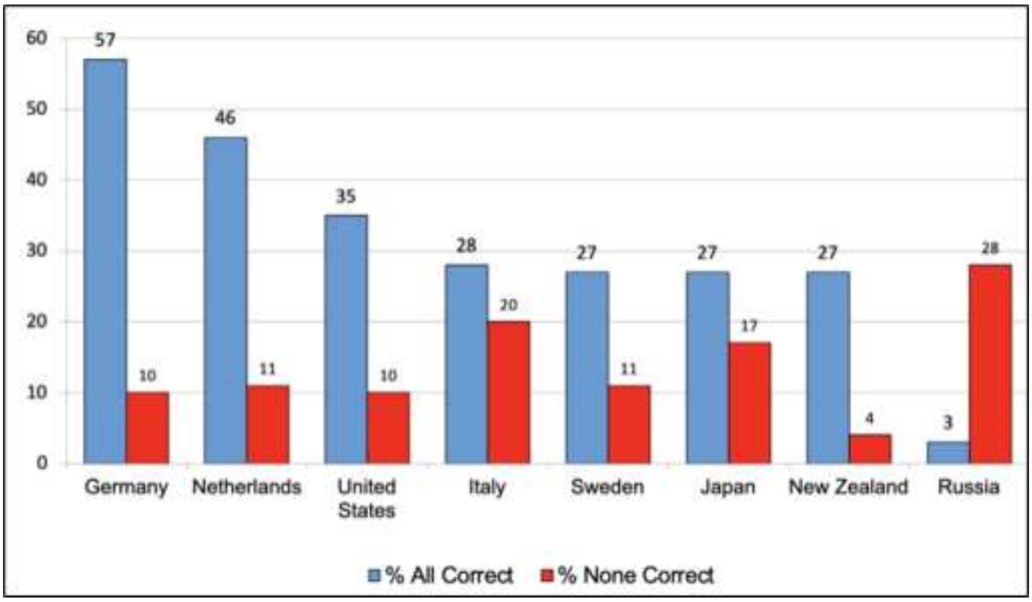

Figure 11.2: Financial Literacy in Several Countries (Source: Lusardi and Mitchell (2011))

Other pertinent financial concepts have been included to our measure of financial literacy. The majority of our previous conclusions using the Big Three are confirmed by these expanded financial literacy measures, which also include our Big Five measures. They include additional domains of financial decision-making. [13]

Financial capacities are typically highlighted in financial literacy research. According to Harvard Professor Amartya Sen, the best way to define capability is as the chance to reach worthwhile combinations of human functioning, or what a person is able to do or be (Sen, 2005). Accordingly, financial aptitude refers to a consumer's capacity to act in their best financial interest by utilizing their understanding of financial concepts and goods as well as their access to financial products and services. An in-depth analysis of the concept reveals that capability considers not only the information and skills that an individual possesses internally, but also the external environment and variety of opportunities that are accessible (e.g. access to products services and institutions). Financial capacities are structural in nature and extend beyond an individual's perspective. Broadly speaking, financial literacy is a prerequisite for financial aptitude, and this is the basis for differentiating between the two since financial literacy is considered a subset of financial skills. [14] People may have the necessary internal capabilities, but Nussbaum (2011) contends that the absence of external conditions in society renders them incapable, and the opposite is also true. He emphasizes the importance of legislation, policymakers, and service providers to offer a framework that shows people the entire spectrum of abilities required for their well-being. Regarding dependency, though, it's not really apparent which of these two conceptions comes first. [15]

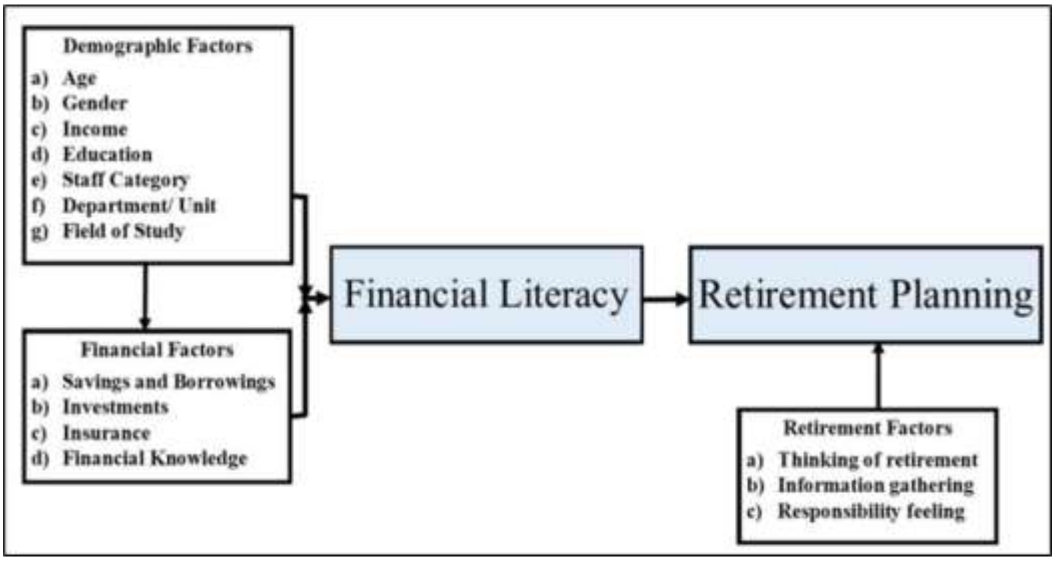

Figure 11.3- Conceptual Framework Relating Financial Literacy and Retirement Planning (Source http://www.Ijmsbr.com) [16]

11.5.2 Financial Planning for Retirement:

In the industrialized world, retirement has extended in duration, and as a result, the number of pensioners has increased as well, raising concerns about the viability of social safety net programs like Social Security. The set of actions involved in building wealth to meet demands in the post-retirement period of life is known as Financial Planning for Retirement (FRP). [17]

Other aspects related to capacity should be taken into account (See Figure 11.4). First, according to Webster and Kruglanski (1994), the need for cognitive closure is the need of the person to have answers to an issue that are unambiguous and definite. There are notable distinctions between individuals who have a high and low demand for cognitive closure in terms of the amount and quality of information they process, the application of decision rules, and their degree of self-assurance in their choices, according to empirical studies. As a result, individuals who have a high need for cognitive closure tend to concentrate on information that is simple to understand, reject complicated or incomplete information, make decisions more quickly, and have a strong need to find closure and retain it for good. Although its impact has been demonstrated in a wide range of decision-making processes, its evaluation in FPR has not yet been completed (Dolinski et al., 2016). We argue that Need for Cognitive Closure offers an intriguing path to develop Hershey's model, as some empirical research has suggested, because of the complexity and uncertainty involved in FPR, which implies the processing of complex information and the anticipation of needs with a high degree of uncertainty. [18]

Second, FPR is a challenging task that frequently causes anxiety. Therefore, ideas about one's own cognitive system, the factors influencing it, attention, and assessment of the significance of one's own are all considered to be a part of metacognition. A recent empirical study indicated that investigating the role of metacognitions is promising because of the intricacy of FPR and the concerns related to it. Positive and negative thoughts about one's own concerns, cognitive trust, and self-attention, in particular, may be significant factors in the associations between planning ability and FPR.

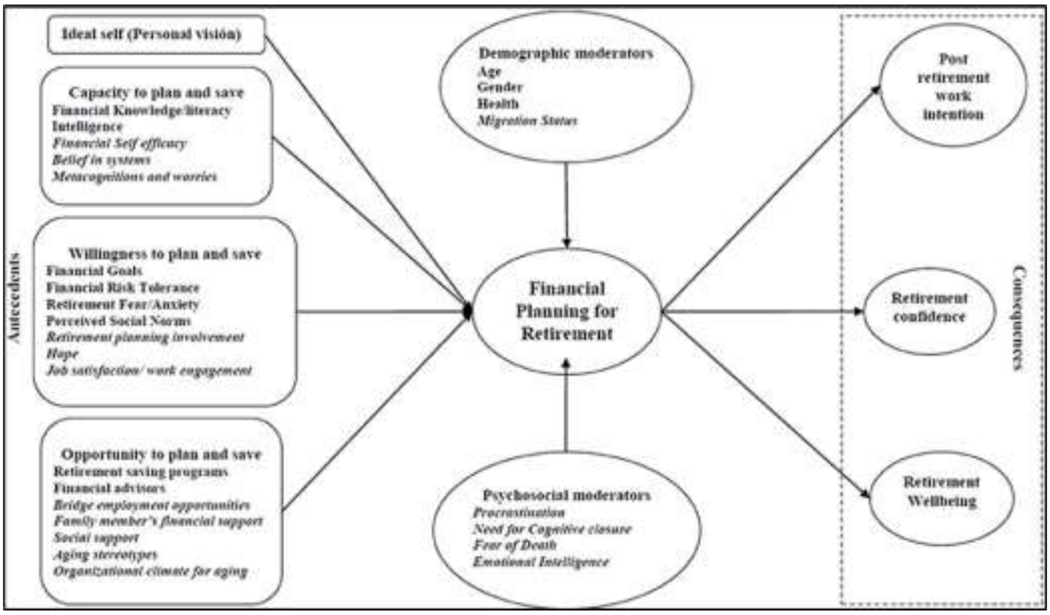

Figure 11.4. Expanded Model for FPR. Variables in Italics Reflect the Extensions for the Original Hershey's Model on FPR. (Source: www.frontiersin.org) [19]

The following offers a startling examination of both the conventional approaches to retirement investing and a novel strategy based on life-cycle finance, as defined by economists.

An economic theory called the life-cycle hypothesis (LCH) addresses how people save and spend their money over the course of a lifetime. It is assumed that people budget their money throughout their lives while keeping their future earnings in mind. It deals with the typical issue of maximizing satisfaction over a period of life with many unknowns, such as thirty years of working and saving and then thirty years of spending. [20]

11.5.3 Life Cycle Finance:

The study of risk and how to use that knowledge to make our lives better are central to the field of finance.

11.5.4 Life Cycle Consumption:

In this sense, consumption encompasses both expenditure and leisure (not working during awake hours). The concept of "life-cycle consumption" holds that people should try to balance their spending over the course of a lifetime in order to optimize happiness, borrowing during lean times and saving during prosperous ones. [21]

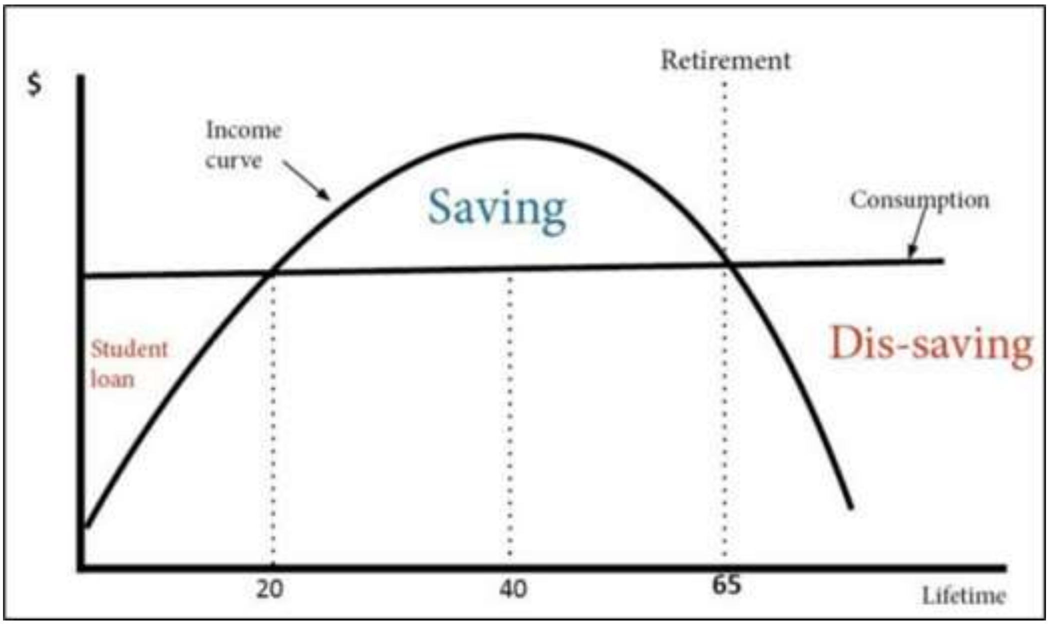

Figure 11.5: Life-Cycle Consumption is the Idea that Individuals Seek to Smooth Consumption Over the Course of a Lifetime to Maximize their Happiness. (Source: www.economicshelp.org)

11.6 Conclusion:

According to the study's findings, a retiree's financial welfare is positively impacted by retirement preparation, family support, and financial literacy. More significantly, retirement planning and family support have a greater positive impact on retirees' financial wellbeing than does financial literacy.

The results suggest that retirement planning and financial knowledge should be encouraged. It is important to prioritize seniors' financial well-being in addition to measures that support family values and foster social cohesion. Low-income individuals tend to downplay the significance of financial literacy when it comes to retirement planning and financial behavior.

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