IMPACT OF THE FINANCIAL LITERACY AND HOUSEHOLD INDEBTEDNESS: EVIDENCE FROM HOUSEHOLD IN GAMPAHA DISTRICT

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ABSTRACT

In the present scenario, Financial Literacy issues are being addressed globally and measures to increase the population's knowledge in a similar trend will be very useful. Consequently, this impact carries away a conviction of the world of finance to get off from careless choice of financial products. This study aims to identify the impact of financial literacy on the Household indebtedness in Gampaha District in Sri Lanka. There is a limited number of research related to Financial Literacy and Household Indebtedness conducted in Sri Lanka but still none of them talk about the relationship between Financial Literacy and Household Indebtedness in Sri Lanka. Hence, we have selected this study. We have developed the model to evaluate those two variables. To measure Financial Literacy, we have identified the most significant three factors Financial Knowledge, Financial Attitude and financial behaviour. Then, to measure household indebtedness, we used information about household debt, such as household loan defaults and how much debt is paid off compared to monthly income. We selected the realism philosophy to find out the relationship between the level of Financial Literacy and Household Indebtedness in Sri Lanka. Realism research philosophy relies on the idea of independence of reality from the human mind. The results of the data analysis and the comments on the results using the appropriate method. All the data collected from the respondents were interpreted and summarized by using the SPSS software. Finally, the researcher found there is a negative association since a negative correlation was found between financial literacy and household indebtedness in Sri Lanka. This study can be replicated by using different proxy measures, extending it cross-country, and increasing the sample size and duration of the data to see if the results differ from the current study.

Keywords: Financial Literacy, Household Indebtedness, Financial Knowledge, Financial Attitude, Financial Behaviour

1. INTRODUCTION

"Financial Literacy is a measure of the degree to which one understands key financial concepts and possesses the ability and confidence to manage personal finances through appropriate, short-term decision-making and sound, long-range financial planning, while mindful of life events and changing economic conditions" (Remund, 2010). According to Abeysuriya, he stated that people have all levels of ability to reach the financial system of a country through financial inclusion but it can only be effective if the individuals have much awareness of the risks that they are going to take and are sensible more efficient and build a pool of funds for future use or borrow money with a clear understanding of the borrowing costs and their potentiality to settle up the borrowings within a reasonable period (Abeysuriya, 2018) Organization for Economic Co-operation and Development (OECD) has raked up three basic comprehensive dimensions on Financial Literacy. They are Financial Knowledge, Financial Behaviour and Financial Attitude (Atkinson & Messy, 2012). Previous studies have found that financial literacy has significant effects on decisions involving debt. According to research by Lusardi and Mitchelli, less educated consumers frequently engage in high-cost transactions, paying more fees and borrowing money at high costs. (Annamaria Lusardi, January 2007). Those individuals also tend to have higher debt weight and a higher probability of credit default due to the lack of Financial Literacy. Gathergood and Disney studied the behaviour of UK households to identify the relationship between Finance Literacy and consumer credit portfolios and found that consumers with poor Financial Literacy hold high-cost credit products compared to consumers with higher literacy (Gathergood & Disney, 2011). As well as Lasantha and Pathirawasam have found that lower Financial Literacy may imply that individuals are susceptible to higher credit-related risks (Lasantha & Pathirawasam, 2015). In Sri Lanka, low Financial Literacy has led to a high level of indebtedness and people tend to make risky investments such as in pyramid schemes. This occurred as a result of the spread of unethical or illegal groups operating in Sri Lanka beyond the bounds of the law. They do not consider the long-term effects of their choices; they just consider the immediate necessities. People look for more money when they are having financial difficulties. They think that earning more money will solve their current problems, but they are unaware that their lack of financial literacy is the real source of their issues. Therefore, making such choices will cause individuals to experience more financial hardship (Abeysuriya, 2018). My research is mainly based on identifying the impact of Financial Literacy on household indebtedness in Sri Lanka. And after that We are going to suggest some strategies to overcome household indebtedness in Sri Lanka

Research Questions

The research project will seek to explore and investigate the central problem of, why household indebtedness in Sri Lanka is high, although it has a higher financial literacy than other countries show a negative relationship between Financial Literacy and indebtedness. The main questions of this research are based on.

1) What is the current relationship between Financial Literacy and Household Indebtedness and the impact of Financial Literacy on Household Indebtedness?

2) What are the factors affecting household indebtedness in Sri Lanka?

3) What are the suggestions to improve policy strategies to overcome household indebtedness?

Research Objectives

- To determine the relationship between financial literacy and household indebtedness
- To determine the factors affecting household indebtedness in Sri Lanka
- Suggest decisions and strategies in order to reduce household indebtedness in Sri Lanka

Significance of the Study

Different research studies have found different relationships among Financial Literacy and Household Indebtedness. According to the Sri Lankan context we have found sources that explain that Sri Lanka has a positive relationship between financial literacy and indebtedness but from these sources, we cannot come to a conclusion that Sri Lanka has a positive relationship between financial literacy and household indebtedness. Consequently, from my research study, we are looking to identify the relationship between financial literacy and household indebtedness. Also, we try to find new things/evidence of financial literacy and household indebtedness in Sri Lanka. Nowadays Household Indebtedness is a major issue in Sri Lanka. In recent years public sources proved that household indebtedness has gradually increased compared to previous years. There are many factors which are affecting indebtedness. After doing our research study We can identify factors that impact household indebtedness and also, can give suggestions to improve policy strategies to overcome household indebtedness in Sri Lanka. These policies will help the government, policy makers and future researchers to get an idea to give solutions for household indebtedness. To give suggestions we have to take ideas about household indebtedness from policy makers in Sri Lanka. Finally, we can tell that this research gives solutions and understanding for one of the main issues in Sri Lanka.

2. LITERATURE REVIEW

The term Financial Literacy has been defined by a number of scholars and as a result, it has various theoretical definitions which are seen by some authors in terms of general literacy and essential skills, where Financial Literacy is defined as the ability to acquire and use financial information, as measured through comprehension and performance of a financial task (Mason & Richard, 2000). Hence in conclusion, this definition states that financial literacy is the application of more general literacy, numeracy, problem-solving, and other key essential skills in a personal finance environment rather than existing as a distinct set of talents (Murray, 2013). This conveys that Financial Literacy or capability includes specific or certain general skills or abilities a person holds. Among those numbers of different definitions, some scholars have touched on several dimensions of Financial Literacy. As an example, John Gathergood has defined Financial Literacy as, "Consumer understanding of financial concepts and ability to correctly interpret financial data" (Gathergood & Disney, 2011) and according to Lusardi and Mitchell, defined, financial literacy is the ability to perform calculations involving interest rates and the understanding of fundamental financial investing principles like inflation and risk diversification.

(Lusardi, 2011). Both of them implied that Financial Literacy is occupied with knowledge of financial concepts. Likewise, Noctor et al. have defined Financial Literacy as the ability to make informed judgments and make effective decisions regarding the management of money (al, 1992). Importantly, David L. Remund has categorized those various definitions of Financial Literacy into five main dimensions after referring to many definitions as, 1) knowledge of financial concepts, (2) ability to communicate about financial concepts, (3) aptitude in managing personal finances, (4) skills in making appropriate financial decisions and (5) confidence in planning effectively for future financial needs. He has distinctively defined Financial Literacy and the roots of that definition have stretched on the importance of ability, and it speaks to knowledge, skills, and life changes. Therefore, we have chosen my operational definition of, Financial literacy as " A measure of the degree to which one understands key financial concepts and possesses the ability and confidence to manage personal finances through the appropriate, short-term decision making and sound, long-range financial planning, while mindful of life events and changing economic conditions" (Remund, 2010) When in comparison with the each of definitions that We have collected by referring various past types of research, most of the definitions are covering at least one of these above dimensions and also many of them have focused on the aspects like, awareness, knowledge, skill, attitude, understanding and behaviour on financial concepts inside their definitions. Consequently, it is the fact that those definitions are incorporated and linked with those dimensions. In other words, those dimensions are integrated with the core of those definitions. Therefore, after considering those perspectives, we selected this as the most appropriate operational definition to carry on my study as it contains all the necessary aspects of the term, Financial Literacy rather than not sticking to one or two dimensions like the other definitions that We have gathered.

Factors Affecting Financial Literacy

Scholars who have done research regarding Financial Literacy also have found some specific factors that are affecting Financial Literacy. C. A., Robb, and Woodyard A. have described "Personality" as a factor that affects Financial Literacy. Robb and Woodyard and also C. A., Robb, and Woodyard observed that "level of financial knowledge" is another factor (Robb & Woodyard, 2011). When comes to Financial Literacy some of the driving factors are numeracy and the emotional attitude towards numbers thus, becoming financially literate resides in the ability to understand numbers and having an emotional attitude towards numbers (Lind, Thérèse; KennySkagerlund, et al, 2018). Moreover "economic turbulence" Beckmann (2013) Savings behaviour Stix (2011), and Planning behaviours Lusardi and Mitchelli (2007) can be taken as another factor, and apart from that some scholars have found that there are some demographic factors that affect Financial Literacy (Lusardi & Mitchell, 2007). Moreover, according to previous researchers, financial knowledge, financial attitude, and financial behaviour which are the dimensions of financial literacy are affected by the socio-economic and demographic factors like age, gender, income, and family background of an individual (Lusadi A. M., 2010); (Lusadi A. M., 2011); (Allgood & walstad, 2013). Similarly, Shirantha Heenkenda also investigated that there is a strong relationship between the financial literacy of individuals and socio-economic-demographic characteristics. This study further explained that financial literacy differs from person to person based on levels of income, knowledge, education, etc.

Current research related to Financial Literacy

Financial Literacy can be identified as a vital necessity for economies that are rapidly developing in parallel with the developed economies to enhance the financial well-being of their populations. Consequently, it is a fact that Financial Literacy is a way of accelerating the financial well-being of a person. Alwee Pg Md Salleh showed that households who have a sense of financial literacy can handle day-to-day financial tasks, deal with financial emergencies and even drive through the clutches of poverty. Lusardi and Mitchell (2007) and Pg Md Salleh (2015) who have done a number of researches regarding financial literacy, reported that financial literacy owns an integral component termed, debt literacy since it integrates the potentiality of taking simple decisions regarding debt and relating interest compounding knowledge to real-life situations (Neha & Singh, 2017).

Household indebtedness

We have found several definitions for the term "Indebtedness" and some researches have defined it as "Over-indebtedness". It is a fact that mostly they have focused on the concept of over-indebtedness. But even when we are analysing those definitions, we can see considerable differences in those definitions since they have focused on different levels of indebtedness when defining the term indebtedness. Consequently, we think that it is more suitable to stick to this definition of indebtedness which is defined as "Households' existing and expected resources are insufficient to meet its financial commitments without lowering its standards of living" (Commission, 2010).

Relationship between Financial Literacy and House hold Indebtedness.

Furthermore, they have mentioned that usually, the people who have higher financial literacy have debt literacy Lusardi and Tufano (2009) with the correct understanding of the concept of interest compounding and the time value of money (Atkinson & Messy, 2012), (Rooij, Lusardi, & Alessie, 2011,) (Lusardi, 2011). When considering past research, it is important to highlight that a low level of financial literacy is a prevailing phenomenon in debt literacy which impacts household indebtedness. The term household indebtedness has been defined in various ways by the past scholars. More importantly, we can see a relationship between Financial Literacy and Household Indebtedness which has turned out to be the underlying basement for our study. By averring it, Richard Disney and John Gathergood have found that Financial Literacy has a very strong effect on self-reported financial over-indebtedness by using a range of measurable tests (Gathergood & Disney, 2011). For instance, consumers who have low financial literacy usually obtain high-cost credit cards and they get over debt (Lusardi & Tufano, P, 2009). Likewise, some studies investigated that people who have better financial knowledge can make the best financial decisions. For example, Lusardi and Mitchelli (2007) found that people with higher financial knowledge are able to plan for retirement. Moreover, according to Disney and Gathergood (2013), people with low levels of financial literacy have a tendency to underestimate the cost of credit and are therefore more likely to accrue debt. As a result, families with lower levels of financial literacy typically have higher debt loads and may even go overboard with their debt. When people lack the ability to discriminate between a safe investment and one that could be quite dangerous, they become subject to the variety of financial goods available on the market and are more prone to experience financial issues like debt and default. (Lyons, 2004). In conclusion, low levels of financial literacy may impair people's ability to save money and accumulate wealth (Lusadi A. M., 2010).

3. METHODOLOGY

The study's research technique is described in this section. This section will also describe the research approach, research strategy, data collection methods, data collection technique, population and sampling, data analysis, and hypothesis testing.

Research Philosophy

We selected the realism philosophy to find out the relationship between the level of Financial Literacy and Household Indebtedness in Sri Lanka. The research philosophy of realism is based on the notion that reality is independent of the mind.

Research Approach

This study mainly focused on finding the association between the level of financial literacy and household indebtedness of the respondents in the Gampaha District in Sri Lanka by using a deductive research approach. Continuously rising household indebtedness is one of the burning issues currently faced by Sri Lankan households Sri Lanka has a considerable level of Financial Literacy compared to other South Asian countries while other countries show a negative relationship between financial literacy and household indebtedness. This section will analyse how our independent variable and dependent variable are going to integrate and what methods and techniques that will be used to carry out to achieve the main objectives of this study

Population and Sample

The population of the study is indebted households in Gampaha District. According to the Department of Census and Statistics, there are 1 295 316 indebted households in Gampaha District as of 2016 and We will be selecting respondents only from J-Ela, Negombo, Kadana, Katunayake, Minuwangoda cities in the Gampaha District limit as our population study due to the limitations of time and accessibility with corvid-19 situation.

We are planning to gather information from the National Housing and Development Authority in Gampaha and out of their information We will be selecting 483 indebted households for the sample size. Convenience sampling will be used to select the 483 indebted households from the National Housing and Development Authority Gampaha.

Research Strategy

The data will be gathered by structured and pretested questionnaires. An assessment of the available surveys revealed that they were comprehensive and covered financial behaviour, financial attitude, and financial knowledge. All three topics should be covered in a nationwide survey, and the questionnaire should be created using questions from past polls. Particularly helpful are those that underwent considerable development and testing to inform their design, such as the United Kingdom (FSA baseline survey), Statistics Canada, Ireland, and the Netherlands CentiQ. In order to select key questions that would enable the collecting of similar data, we also looked into the questions asked in each of these three subject areas in some depth in past surveys.

Based on the assumed impact of independent variables on household indebtedness, the following conceptual framework was developed.

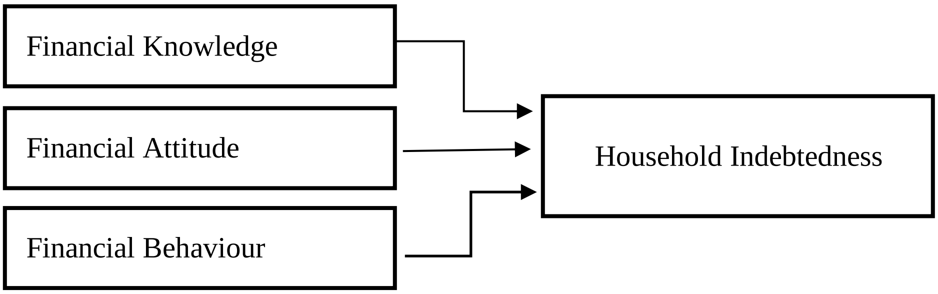

Figure 1. Conceptual Framework

Operationalization and Hypothesis

H1: There is a statically significant negative impact of Financial Knowledge and household indebtedness

H2: There is a statically significant negative impact of financial Attitude and household indebtedness

H3: There is a statically significant negative impact of financial behaviour and household indebtedness

Data Collection Method

The researcher used single data collection techniques and corresponding analysis procedures. The researcher selected a mono method for the research.

Data Analysis Methods

This research uses a deductive approach since my problem statement is based on the conclusions given by past researchers regarding the relationship between Financial Literacy and Household Indebtedness. Therefore, this study mainly focuses on finding the relationship between two variables. One is Financial Literacy and the other variable is Household Indebtedness.

We have to use both quantitative and qualitative methods to analyse the gathered data. Quantitative data will be statistically analysed using the SPSS software platform

Interpretation of result

• Correlation coefficient we are going to use the Correlation coefficient to measure the strength of the relationship between Financial Literacy and Household Indebtedness

• Regression Analysis will carry out the regression analysis to determine how the changes in Financial Literacy are associated with the changes in Household Indebtedness. As well as to measure the variation between those two variables multiple linear regression analysis will be carried out.

4. FINDINGS AND DISCUSSION

Reliability analysis was used to measure the internal consistency of the items which were used to measure respective variables.

Table 1. The Cronbach's Alpha Value

	Alpha Cronbach's	No of Items
Financial knowledge	.776	6
Financial Behaviour	.700	8
Financial Attitude	.711	8
Household Indebtedness	.651	5

KMO statistics were used to measure the sampling adequacy. As per the results in Table 02, the KMO statistic is 0.830 (above 0.5), which indicates that the selected sample size is sufficient to continue the analysis.

Table 2. Kaiser-Meyer-Olkin (KMO) and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.830
Bartlett's Test of Sphericity	Approx. Chi-Square	3051.911
	Df	276
	Sig.	.000

Correlation Analysis

Researchers used Pearson Correlation Analysis to measure the relationship between dependent and independent variables. The findings indicate that the correlation between household indebtedness and financial literacy is statistical significance at the 0.01 level.

Table 3. Correlations Analysis

Independent Variable	Dependent Variable	P- Value
Financial knowledge	-.022	0.000
Financial Behaviour	-.021	0.000
Financial Attitude	-.036	0.000

Significant negative relationships were found between financial knowledge ($r = -0.020$, $p<0.01$), financial behaviour ($r = -0.021$, $p<0.01$), financial attitude ($r = -0.036$, $p<0.01$), and household indebtedness. These findings support all three hypotheses of this study.

5. CONCLUSION(S)

The amount of financial literacy—or what (Lusardi & Tufano, 2009) refer to as "debt literacy"—in the context of household debt in Gampaha has been studied in this article. A significant regular survey of the debt position of a representative sample of working-age households was supplemented with specialized questions on numerical aptitude and other background traits.

The findings draw attention to causes for worry. Although it appears that most people have some very basic financial knowledge, a sizable section of the population in every nation lacks comprehension of other, more common financial concepts like compound interest and diversification. Additionally, there is some evidence that some responders are overconfident because they have submitted wrong answers rather than coming clean about their ignorance.

Analysis of the relationship between behaviour and household indebtedness suggests a negative association: when behaviour is positive, indebtedness decreases. This does not prove causation, and much more research is needed to understand the relationship between these variables. It may be that improved behaviour leads to more active participation in financial markets and less borrowing behaviours.

Additionally, there is a negative correlation between attitudes and household debt. People who are more likely to be engaging in financial behaviour are those who have a good outlook on the long term as opposed to those who favour the short term. Further research is necessary to understand this link.

Inequality in opportunity may be keeping people from becoming more financially savvy, according to sociodemographic analysis. Particularly, low levels of education and income are linked to lower levels of financial literacy, indicating that some groups may already be shut out of possibilities for learning and participation in activities that might enhance their financial well-being.

The analysis' findings offer data from which the participants may pinpoint needs and gaps and create the best national policies and plans. This pilot project is meant to pave the way for a regular data gathering, analysis, and reporting program

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