

# THE RELATIONSHIP BETWEEN FINANCIAL LITERACY AND RISK PROFILE AMONG YOUTH

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## ABSTRACT

*The purposes of the study are: to determine the level of financial literacy among youth and to examine the correlation of the financial literacy to risk a profile. In this study, a survey instrument which included 34 items that measures independent variables of financial literacy, using multiple choice questions and scores calculated by the percentage of the correct answers. The dependent variable measured using risk profile questions. A sample consisting of 535 college students participated in the study. The data analysis technique is used: 1). Percentage of the correct answers to determine the level of basic and advance financial literacy; 2). Identify investment preference to find out the respondent risk profile; 3). Spearman analysis to testing the correlation of financial literacy and risk profile. The mean correct answer is 56.6% and its level remains low. Respondents who can achieve the high score of the basic financial knowledge and advanced financial knowledge only 8.6%. Bank Account is the most popular preference investment product for college students, which is held by 88.8% of the respondents as conservative risk profiles. Spearman correlation test is used to analyze the data. The results showed that financial literacy and risk profile is a significant correlation.*

**Keywords:** Advanced financial literacy, Basic Financial Literacy, Finance, Financial Literacy, Risk Profile



## INTRODUCTION

Recently, financial literacy has become an interesting issue in both developed and developing countries. Most of the previous study shows that the level of individual financial literacy remains low. In simple terms, financial literacy is defined as knowledge and understanding of finance, confidence to apply the knowledge and understanding to effective financial decisions that can affect personal quality of life. The Effect of the increase of financial literacy can boost economic participation and social inclusion, drive market competition and market efficiency in the financial services sector, as well as contribute to economic health and society.

The National Survey on financial literacy in 2013 and 2016, Indonesians level of financial literacy is low. Over 75% of Indonesians have insufficient literacy. In 2015, survey was conducted by The World Bank shows that two out of three people in Indonesia are not financially literate. The data of the World Bank that obtained from a survey on 150 thousand people from 140 countries, Indonesian financial literacy level is 32%, it is smaller than the average of all countries. In 2017, financial literacy in West Java only reached 7.79%. The Vice Governor of West Java, appealed that education about financial literacy should continuously be given to the community. This condition describes financial knowledge to be important and necessary to improve by individuals.

Previous research proved that individuals with low levels of financial literacy lead to wrong financial decision-making. Therefore, to make sound financial decisions and ultimately achieve financial freedom and wellbeing, individuals necessarily have awareness, knowledge, skill, attitude and behavior in finance. To make financial decisions, investors often take risks. Having poor decisions can be made because they do not have enough financial knowledge, especially advanced financial knowledge. For that reason, financial literacy is important. An individual who has a high financial literacy level can make better financial decisions, especially related to daily activities in making decisions to save, invest and achieve wealth personal goals. Not only beneficial to the individual itself but also beneficial for the sustainability of a country's economic system. From previous studies and surveys above, this study conducted not only to determine the level of both basic financial literacy and advance financial literacy among university students but also determine their risk profile.

## LITERATURE REVIEW

Financial Literacy is the ability to understand the knowledge and skills to manage financial resources to achieve prosperity (OJK, 2014). APEC Guidebook on Financial and Economic Literacy in Basic Education (2014) gives some reasons why financial knowledge is important: Financial literacy is a lifelong learning -process, it precedes financial decisions and could change a better life. An early start helps young people from positive attitudes around money. Lusardi & Mitchell (2017) conducted a study of financial literate and relationship with retirement planning. This study used the American Life Panel Survey Method to 989 people aged 18<sup>th</sup> and above. The measurement uses basic financial literacy concepts: compound interest, inflation and time value of money and the sophisticated financial literacy concept to measure more advanced financial knowledge: risk/return, the difference between stock and bonds, and the relationship between bond prices and interest rates. The results show that people with more advanced financial knowledge are more likely to do retirement plans and are ready facing pensions.

Danes & Hira (1987) conducted a study on money knowledge management for students at Iowa University. The results showed that students have a high knowledge level in

personal loan and record keeping but lower in insurance and credit card knowledge. Chen & Volpe (1998) conducted a survey of 924 students to determine the level of financial literacy and the relationship between financial literacy and student characteristics. The results showed that the level of student financial literacy is 53%. Chen & Volpe (2002) conducted survey gender differences in personal finance knowledge among college students. This study shows that on average men know more about personal finance than women. de Bassa Scheresberg (2013) survey of 4500 young adults aged 25-34 years from US National Financial Capability Study (NFCS) data. This study found that financial literacy is still low. Respondents who have high levels of financial literacy have a high financial outcome, plan their retirement and save for an emergency expense.

Previous studies show there is a strong relationship between financial literacy and financial management skills (APEC Guidebook on Financial and Economic Literacy in Basic Education, 2014; Lusardi & Mitchell, 2014; Lusardi et al., 2010). Lusardi et al. (2010) examined financial literacy among the young adults that is low, fewer than one-third of young adults possess basic knowledge of interest rates, inflation, and risk diversification. Financial literacy was strongly related to socio-demographic characteristics and family financial sophistication. Bhushan & Medury (2013) also proved the level of financial literacy among salaried individuals is low and affected by gender, education, income, nature of employment and place of work. Lusardi & Mitchell (2014), financial literacy is a way that can affect financial behavior. The level of Financial Literacy can be measured through testing their ability of basic financial knowledge and advanced financial knowledge. Advanced financial knowledge is an understanding of risk diversification that relates to short term and long term saving and investment.

Akben-Selcuk (2015) conducted a study of 1539 students to determine factors affecting the financial behavior of students in Turkey. Three financial behaviors studied were paying bills on time, budgeting, and saving for the future. The results showed that the students who have high financial literacy will show better financial behavior. Thapa (2015), examine financial literacy of college students in Nepal. The study found the basic level of financial knowledge is affected by demographic, educational and personality characteristics. OECD/INFE International (2016) conducted a survey of 51,650 adults, with range age 18-79 years in 31 countries. The results show the level of financial literacy is relatively low. Respondents who can achieve the target minimum score of 70% answered correctly, on average the whole country only 56%. Aren't & Zengin (2016), proved that risk-perception is affected by financial literacy. Wang (2009), proved that financial knowledge and risk taking has correlation. Nguyen et al. (2016) studied the influence of financial risk tolerance on Investment Decision and the results show a positive relationship between risk tolerance and financial literacy. While other research proved negative correlation between perceived risk and financial literacy (Sachse et al., 2012).

## **METHODOLOGY**

The population of this study is college students in Parahyangan Catholic University. The questionnaires are distributed to all students using an online survey, and only 535 students fill out the questionnaires. The profile of respondents by gender is 52 % female and 48% male. Respondents ask questions to cover dimensions of basic financial literacy and advanced financial literacy. Basic Financial Literacy includes financial literacy on general knowledge, interest rate and inflation and time value of money. A risk diversification question is to measure advanced financial literacy. The respondents are asked to answer seven questions as demographic data and 34 multiple choice questions of financial literacy. The calculated score is based on the percentage of the correct answer. The questionnaires also

consist of questions about investment preference to find out the respondent risk profile. Spearman correlation analysis assumed the two variables were measured on at least ordinal scales. Correlations were flagged as significant if the p value was less than 0.05.

## RESULTS AND DISCUSSION

By the mean percentage of correct scores for each question, the level of financial literacy of students is 56.6%. Referring to the classification of Danes & Hira, (1987); Volpe et al.(1996) which divides the financial literacy into three, namely (1) more than 80% of the correct answers are categorized relatively high literacy rates, (2) between 60% to 79% of the true correct answers are categorized medium and (3) below 60%, the correct answer is categorized as a relatively low literacy level, so that the financial literacy rate of students is low.

Level of Financial Literacy	Range Level	General	Interest and Inflation	Time Value of Money	Risk Diversification	%	%	%	%
High	>79	40	142	224	46	7.5	26.5	41.9	8.6
Middle	60-79	138	145	163	131	25.8	27.1	30.5	24.5
Low	<60	357	248	148	358	66.7	46.4	27.7	66.9
Total		535	535	535	535				

Source: Survey Result.

Table 1 shows the result of the financial literacy level in each variable of this study. The results show the level of financial literacy is relatively low. Respondents who can achieve the high score of the basic financial knowledge and advanced financial knowledge only 8.6%. This study shows that the level of financial literacy of students' financial knowledge is low. Basic financial knowledge about the concept of time value of money has a high level, is owned by 41.9% and others have a low level. Students who have low levels of financial literacy are 54.2%, medium 41.7% and high 4.1%.

Risk Profile	Product of Financial	Frequencies	Percentage
Conservative	Bank, Mutual Fund	475	88.8%
Moderate	Bank, Mutual Fund, bond	7	1.3%
Aggressive	Bank, Mutual Fund, bond, Stock	53	9.9%
		535	100%

Source: Survey Result.

Table 2 shows that risk profile is categorized into three types: conservative, moderate and aggressive. Bank account: saving, deposit and current account is the most popular preference investment product for students which are held by 88.8% of the respondents is conservative. 68% of the students had preference with only one investment. About 13% of students have preference for 3 or 4 different investment products. And none of the respondents had a preference with 5 or more different investment products.

Spearman correlation was calculated to test that financial literacy is linked to risk profile. The result shows that correlation is significant ( $r=0.804$ ,  $n=535$ ) (Table 3).

<b>Correlations</b>				
			FL	RP
Spearman's rho	FL	Correlation Coefficient	1.000	0.804**
		Sig. (2-tailed)	.	0.000
		N	535	535
	RP	Correlation Coefficients	0.804**	1.000
		Sig. (2-tailed)	0.000	.
		N	535	535
**Correlation is significant at the 0.01 level (2-tailed).				

### CONCLUSION

The findings of this research are: First, on average the score of respondents about 56.6% of financial literacy questions correctly. It indicates the level of financial literacy on average is low. Second, 88.8% of the respondents are conservative. 68% of the students had preference with only one investment. Third, the spearman correlation analysis showed that financial literacy has a significant relationship with the risk profile of students.

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