CHAPTER 1
INTRODUCTION

1.0. Preamble

This study was concerned to examine the effect of financial literacy on financial behavior with special reference to university students in Indonesia, and the consequential implications for improving financial behavior such as payment attitudes and saving attitudes. Indonesia was chosen as the focus of this research because according to the Indonesian Financial Services Authority (OJK), the level of financial literacy in Indonesia is still far behind from other ASEAN countries. Furthermore, financial literacy studies among working adults are unusual in Indonesia, and the author wanted to measure how financial literacy affects financial behaviour among Indonesian working adults.

1.1. Background of Research

Financial literacy is a fundamental tool that can be the basis for a person to understand more about personal financial management, making financial plans, or making financial decisions, in short, financial literacy is knowledge or ability to manage finances (Chen and Volpe, 1998). Financial literacy combines understanding of everyday situations such asinsurance, credit, savings, and loans (Chaulagain, 2015). Understanding of financial terms and concepts such as investing and managing funds to increase wealth and financial security is also a part of financial literacy. According to the Financial Services Authority (OJK), financial literacy is a series of processes or activities to improve the knowledge, confidence, and skills of consumers and the wider community so that they are able to manage finances well. Financial intelligence is needed by every individual in order to continue to enjoy prosperity (Sugiarto, 2017). However, the level of financial literacy in Indonesia is still far behind from other ASEAN countries.

1.2. Problem Statement

The Financial Literacy Index survey conducted by MasterCard showed that Indonesia got an average score of 62 in 10th place, an increase compared to the previous year where Indonesia was the lowest ASEAN country along with the Philippines. However, this figure is still far below the country with the highest average literacy rate, Singapore, with 71. (MasterCard Site, accessed May 2018). The reason for the demand is a growing middle class with more money available.The level of financial inclusion in Indonesia has indeed improved to close to 80%, but this has not been matched by the financial literacy of the Indonesian people which has only reached 37%. With a new literacy rate of 37% of the total population of more than 268 million people or only 99.16 million people who are already literate in financial service products. This causes the contribution to the economy is still not optimal.

1.3. Research Objective

This study has two specific objectives, which are: 1) To examine the effect financial literacy on payment attitude among working adults in Indonesia. 2) To examine the effect financial literacy on savings attitude among working adults in Indonesia.

1.4. Research Question

This study aims to examine the level of financial literacy among working adul in Indonesia, particularly in terms of financial behavior based on payments attitude and savings attitude. This research has the following objectives:

1. How does financial literacy improve payment attitude among working adults in Indonesia?
2. How does financial literacy improve savings attitude among working adults in Indonesia?

1.5. Significance of Research

As the respondent related to financial literacy in Indonesia but only in certain areas, it is necessary to conduct cross-cultural studies. Previous research also needs to be repeated to increase the validity of the findings, especially related to new findings. Other variables that can affect the continuity of use and the addition of a larger sample also needs to be done because it can cause different results. This study aims to determine how the level of financial literacy affects financial literacy and financial behavior of students positively, as well as how much financial literacy is owned by the working adults in indonesia.

1.6. Scope and Limitations of Research

This study focuses on the determine the extent of financial literacy among working adults, specifically in terms of financial behavior based on payments attitude and savings attitude. Data will be collected from working adults in Indonesia who will be selected by cluster sampling to represent the population. As a result, the findings do not fully reflect Indonesia's actual level of financial literacy.

1.7. Operational Definition of Terms

1) Financial Literacy

Financial literacy is a fundamental tool that can be the basis for a person to understand more about personal financial management, making financial plans, or making financial decisions, in short, financial literacy is knowledge or ability to manage finances (Chen and Volpe, 1998). Financial literacy combines understanding of everyday situations such as insurance, credit, savings, and loans (Chaulagain, 2015). Understanding of financial terms and concepts such as investing and managing funds to increase wealth and financial security is also a part of financial literacy. According to the Financial Services Authority (OJK), financial literacy is a series of processes or activities to improve the knowledge, confidence, and skills of consumers and the wider community so that they are able to manage finances well. Financial intelligence is needed by every individual in order to continue to enjoy prosperity (Sugiarto, 2017)

2) Financial Behavior

Financial Behavior is also defined as how good a household or individual manages financial resources that include savings budget planning, insurance and investment.interest (Baker et al., 2017). On the contrary, the behavioral finance discipline is built on the idea that not all financial decisions are rational but the result of psychological influences (Baker et al., 2017; Goyal et al., 2021; Hilgert et al., 2003; Holbrook and Hirschman, 1982; Olshavsky and Granbois, 1979) and demographics (Allgood and Walstad, 2013; Robb and Woodyard, 2011).Xiao et al. (2011) and Goyalet al. (2021) suggest multiple behavioral theories and explain the concept of financial behavior. The most renowned is the theory of planned behavior (Ajzen, 1991) which connects consumers' attitude and their behavior. In this context, attitudes towards personal finance significantly impact financial behaviors (Goyal et al.,2021). The life-cycle theory proposes that as individual ages or proceeds through their life stages, their financial behaviors will optimize or maximize their utility and smooth consumption based on their current and future resources (Ando and Modigliani, 1963; Attanasio and Weber, 2010; Betti et al., 2007; Modigliani, 1966; Xiao et al., 2011). Prospect theory describes individuals' decision-making and financial behaviors when considering risk through the concept of loss aversion (Kahneman and Tversky, 2013; Xiao et al., 2011). Consumer socialization theory or parental financial socialization is based on the idea that individuals' financial knowledge, skills and behaviors are influenced and modeled by mentors such as parents, teachers, friends and media (Allen, 2008; Danes, 1994; Goyal et al.,Consumer financial behaviors 2021; Xiao et al., 2011). The consumer socialization theory and social learning theory (Bandura and Walters, 1977; Goyal et al., 2021; Shim et al., 2010) proposes that individuals model their behavior by observing others enacting similar behaviors. In this context, an individual observes another person's financial behaviors (positive or negative) to determine their behavior (Goyal et al., 2021; Shim et al., 2010). Altfest (2004, p. 54) defined financial behaviors (PFM behaviors) as "[...] a process which assimilates all components of individual financial interest. These include cash flow management, investments, risk management, retirement planning, tax planning and real estate planning." Xiao (2008, p. 70) defines financial behaviors simply as "any human behavior that is relevant to money management." Outside academic research, CFSI describes financial behaviors as the composite or aggregation of an individual's behaviors that determine one's ability to withstand financial shocks and positively influence their current and future financial situation (Parker et al., 2016). Researchers used proxies to represent financial behaviors before Dew and Xiao's (2011) financial management behavior scale.