Chapter 11

The Role of Financial Inclusion: Does Financial Inclusion Matter?

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ABSTRACT

This chapter highlights the importance of financial education, its link with financial decision-making process, comparative status of different countries, and efforts to improve current situation. Unfortunately, there is no standard definition for neither financial education nor measures to quantify it. Therefore, this chapter first aims to provide a comprehensive definition in order to explain how financial knowledge affects the decision-making process. Then, financial literacy measures from previous studies over different countries would be discussed to show financial illiteracy problem is global. Lastly, solutions and recommendations would be discussed at three different levels: younger people, individuals, and national strategies.

INTRODUCTION

Recent financial crisis of 2007-8 triggered by the US housing bubble not only cost billions of dollars to the global economy, but also resulted in the collapse of large financial institutions such as Lehman Brothers, one of the biggest investment banks in the world. Some researchers considered this crisis as the worst one since the Great Depression. This is why several regulation changes together with preventive action plans were set into place in order not to experience such a crisis again. Only after a decade, things could get “normal”. Unfortunately, in the other part of the world debt crises sparkled starting from 2010 European sovereign debt crisis: Greece, Portugal,
Ireland, Spain and Cyprus experienced difficulties to finance the government debt. Now looking closer to today’s economic and financial environment, it may be said that everything is fragile and constantly changing: a trade war is going on between the U.S. and China, interest rates and exchange rates are very volatile, once charmingly profitable cryptocurrencies are losing attention, and investment opportunities or safe options are born and fade away very fast. According to the 2019 April Equifax Financial Literacy Survey conducted in the U.S., 49 per cent of total 1071 adults do not have enough savings to cover three months of living expenses, 56 per cent do not have any money left at the end of the month, and 35 per cent do not have any savings for retirement.

Looking back to these few decades, even though the causes of crises vary, one common observation is obvious: not all the participants of global economy has equal and sufficient information. Some households invest in financial instruments, on which they have no idea, some investors do not take financial decisions consciously, or some portfolio managers create complex investment strategies without considering simple profit/loss analysis. The only way to prevent these cases is to ensure the financial knowledge of these participants. Putting aside the investors, households, managers or portfolio managers, who prefer to decide consciously irrationally, financial knowledge or literacy is the power at the individual level to tackle with high-level economic problems. It is not a coincidence that initiatives/global projects/institutions/regulations/nation-wide campaigns on financial literacy are formed over the same past few decades. Therefore, financial knowledge, literacy or education has gained importance as a solution to avoid making financial mistakes.

This chapter aims to clarify why financial inclusion matters to every individual, and through which channels it affects financial decision-making process. Considering that there is no single definition nor a standard measure to measure the level of financial knowledge, this chapter would first focus on previous attempts to conceptualize and develop measures. Then, a comprehensive definition would be introduced to understand what financial inclusion or literacy really refers. Additionally, this chapter would shed light on findings from different countries to demonstrate there is still way ahead not only for developing countries, but also developed economies. Last but not least, solutions in action and recommendations to individuals, policy makers, and/or any other supportive parties would be provided.

BACKGROUND

In contrary to other financial concepts, financial literacy does not have a single definition or even there is not a single phrase to express. Several terms are used interchangeably, such as financial education, inclusion, literacy, knowledge, or skills.
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