FINANCIAL LITERACY AND ECONOMIC ACTIVITIES IN NIGERIA: SOME POLICY OPTIONS FOR DEVELOPMENT

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Abstract

This paper seeks to explain the concept of financial literacy as a vehicle for economic development in Nigeria. Adequate knowledge of finance is needed for individuals to function properly in the area of economic decision making. Financial knowledge is neither a luxury nor a matter of convenience. Rather it has become an integral tool for survival in today's economy. This is due to the fact that the lack or low levels of financial knowledge could lead to the choice and implementation of poor financial decisions which could be injurious to individuals and the entire society. It is against this background that this paper argues that the promotion of financial literacy by financial institutions affects users of financial products and services in a positive manner. The paper concludes that financial literacy encourages financial access and savings which invariably increases economic growth, reduces poverty levels, enhance livelihoods and leads to overall economic development.

Keywords: Finance; Financial literacy; Financial products; Economic growth; Economic development.

JEL Classification: D14; D53; E44; G21.

1. INTRODUCTION

Finance is one of the key components of the life of every individual or community. Adequate financial knowledge is necessary to aid an individual or group to make appropriate financial decisions by selecting and using the right financial products and services (Mitchell and Lusardi, 2015; Anthony-Orji, Orji, Ogbuabor, and Nwosu 2019). Poor financial knowledge and misconceptions about financial products may result in financial losses and a decline in economic conditions. This could also result to poor investment decisions and excessive or wasteful spending (Damayanti, Murtaqi and Pradana, 2018).

One of the key functions of the Central Bank of Nigeria is to ensure a stable and strong financial system in the economy. This can be done through boosting and promotion of public confidence in the financial sector. It has been observed that when adequate attention is given to the interest of consumers, it restores public confidence in the financial system, thereby leading to a more stable economy (CBN, 2016). Financial literacy is one of the ways to ensure the protection of consumers' interests. This is done by equipping individuals with the requisite knowledge needed to take advantage of the various available financial products and services and make adequate financial decisions in order to better their wellbeing (Anthony-Orji, Orji, Ogbuabor, and James, 2019).

Following the recent global financial occurrences, it is pertinent to inquire and determine how financial illiteracy contributes and aids poor economic decisions, which translates to costly financial mistakes. Research has shown evidence that financially literate people are more likely to make better economic plans, invest and earn more on their investment, repay loans and facilities as at when due (Lusardi and Tufano, 2009; Orji, Ogbuabor, Okon, and Anthony-Orji, 2018).

A large percentage of the developing countries are not equipped with rudimentary levels of financial education, which reduces their ability to make adequate decisions pertaining their future financial wellbeing resulting to an exposure to all forms of financial risk. Although the number of educated and literate Nigerians can be said to be on a high level, an equally high percentage of this population lack the required skill to manage their finances adequately and make use of opportunities provided by financial products to increase their financial wellbeing. According to a study by NDIC (2012) on the level of financial literacy in Nigeria, with a sample size of 10,500 adult population aged 18 and above and drawn from the different geopolitical zones of the country, the result of the study showed substantial gaps in the level of financial literacy in the country. It found out that (i) financial literacy was lowest among single respondents. (ii) the literacy gap was more prominent in the areas of money management and financial exposure/ experience. (iii) the possession of education greatly influenced financial literacy in all areas. (iv) there is a high level of willingness of the majority of Nigerians to participate in literacy programmes if the opportunity is provided.

In addition, some consumers of financial services have borne the brunt of certain unethical practices by financial institutions, while others have been short-changed of what is duly theirs as a result of low levels of financial literacy in their relationship with financial institutions. Again, in developing countries such as Nigeria, more and more individuals are becoming more and more involved in newly developing financial markets. Hence, there is a need for an increased level of financial literacy to ensure efficient operation of these markets (Kefela, 2010).

Furthermore, there has been a remarkable growth in the volume of international transactions within the last decade. This development is as a result of new and better technologies as well as an increased level of international mobility of individuals. This development therefore entails that enhancing financial literacy has become a thing of international concern. The main objective of this paper therefore is to conceptually discuss and analyse the relevant issues of financial literacy and economic activities in Nigeria and provide some policy options that will aid development in Nigeria.

2. CONCEPTUAL LITERATURE REVIEW

2.1 FINANCIAL LITERACY

Houston (2010) defined financial literacy as the necessary skills and understanding of basic economic concepts which are required for making savings and borrowing decisions. Its aim is not to make individuals financial experts. Rather, it is to equip people with adequate knowledge and skills needed to make appropriate and effective financial decisions. It entails the application of the acquired financial knowledge without which an individual cannot be said to be financially literate.

Financial literacy is all about the empowerment and the enlightenment of consumers, the impartation of knowledge about finance which aids in the evaluation of financial products and services and helps them to make informed financial decisions thereby adding relevance to their lives. These decisions include when and how to spend and save, how to manage a budget effectively and how to choose the right financial products. Financial literacy enables people to understand the financial options available to them and make most of the opportunities they present. Financial literacy has become an important tool of survival and no longer a tool of convenience. It is highly relevant to developing countries because increase in financial literacy will give rise to sound economic decisions which in turn improves the financial capacities of the individuals in a country and generates higher economic growth rates. Financial literacy also involves the understanding of basic financial concepts, the discipline and ability to use that knowledge or information to make wise, personal and financial decisions. It also encompasses a set of skills through which individual and the general society is developed on all sides and participates in the process of development through the acquisition of knowledge, skills and attitudes (Kefela, 2010).

2.2 ECONOMIC ACTIVITIES AND ECONOMIC GROWTH

Economic activities are actions that involve producing, distributing, or consuming products or services. They also involve the activities of making, providing, purchasing, or selling goods or services. Economic activities exist at all levels within a society and they involve money or the exchange of products or services. On the other hand, economic growth can be regarded as an increase in the production of goods and services over a specific period of time. Goodwin et al (2009) defined it as increases in the aggregate levels of production and income. Economic growth enhances profit for business firms and organizations. As stock prices appreciate as a result of better profit, it increases the capital available to firms. As a result, more jobs are created which in turn increases income levels for individuals and households. With more income at their disposal, consumers spend more on products and services, further stimulating economic growth through increased spending. The most popular measurement of economic growth is the Gross Domestic Product (GDP). GDP takes into account the final production of goods and services produced in a country within a specific period of time. This measurement of growth is adjusted for inflation. In other words, for the measurement of economic growth to be accurate, it must incorporate real GDP i.e. GDP minus the effects of inflation.

2.3 FINANCIAL PRODUCTS

These are investment or securities created to provide long term or short term gains to its buyers and sellers. These products are useful in increasing the amount of money available to one in order to meet stipulated goods such as education, retirement, etc. They come with their potential risks, limitations, costs, etc.

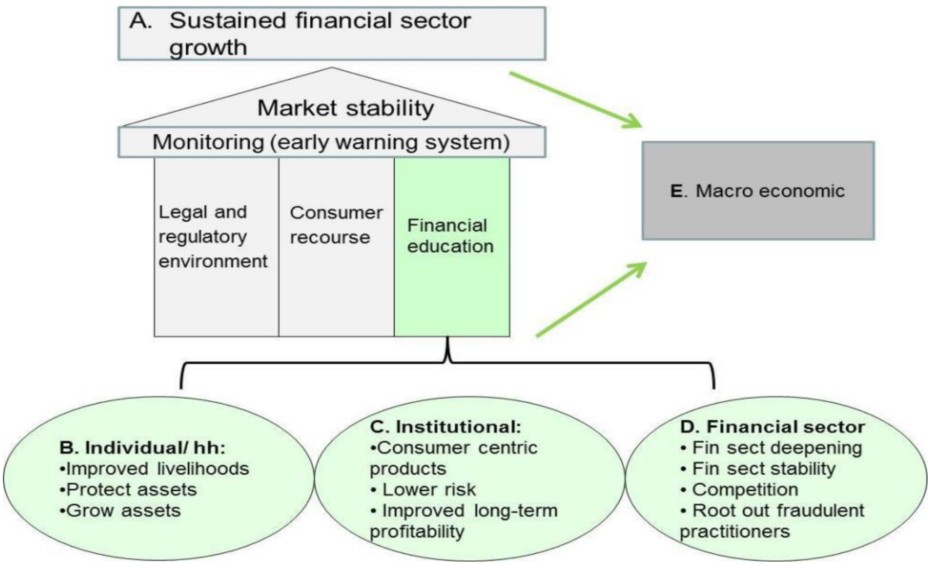

Figure 1: *Linkages between sustained financial sector growth, market stability, consumer protection, financial education and macro-economic growth and stability*

Source: Marketworx

2.4 COMPONENTS OF FINANCIAL LITERACY

For the purpose of this study, the components of financial literacy can be divided into Core competency, Proficiency and Opportunity.

2.4.1 CORE COMPETENCY

A financially literate individual should be competent in the following core areas:

- **Numerical ability** – this refers to the knowledge acquired for constant calculations regarding finance, example: basic calculations related to cost of goods purchase, bill payment, interest calculations, etc. It also involves the ability to understand financial statements, other accounting information, time value of money, etc.
- **Budgeting** – This refers to tracking of expenses and reduction of unnecessary spending. For budgeting to be effective, one must cultivate the ability to live within his means. Budgeting is very essential where there is limited level of income.
- **Savings** – This refers to the act of keeping a certain amount of money aside to be used in future. Savings could either be short term or long term.
- **Borrowing** – Debt literacy ensures proficient borrowing. Borrowing is common for most individuals, households or firms. Proficient borrowing requires that the amount borrowed should be relative to one's earnings. A financially literate person should be competent enough to understand debt and what to do to avoid it, reduce and repay it.
- **Investing** – The ability to choose a suitable portfolio for investment is a core feature of financial literacy which may be physical assets or financial assets. According to Hiroshi (2002), three criteria to consider before choosing an investment include: safety, liquidity and profitability.

2.4.2 PROFICIENCY

All core competencies of financial literacy listed above require a great deal of proficiency. Proficiency in the level of financial knowledge is very important to establishment of financial wellbeing.

2.4.3 OPPORTUNITY

According to a report by UK treasury, financially literate consumers make adequate plans ahead of time, inquire and make use of relevant information, seek advice and know when to implement the advice. This leads to a higher level of participation in the market for financial services.

3. BENEFITS OF FINANCIAL LITERACY

Evidence increasingly abounds with regards to the benefits of financial literacy. Financial literacy enables individuals to plan well for retirement. Studies have shown that appreciable number of workers does not make adequate plans for retirement. Financial literacy can aid an individual who anticipates a drop in income after retirement, to calculate how much he needs to save in order to maintain a constant stream of consumption over his lifetime. This entails making projections regarding future variables such as inflation, income growth, pension benefits, etc. (Lusardi, 2010).

According to Pierre-Carl (2017), financial literacy is associated with better financial outcomes such as efficient savings and better debt management. It also serves as a deterrent to wealth inequality by equipping individuals with the needed skills and knowledge to make good use of financial products available to them. Financial literacy has also been shown to positively promote good financial behaviour in schools.

Furthermore, financial literacy is needed in the labour market by employees to (i) prevent financial distress in workers which might occur when workers lack basic financial literacy skills. Financial distress may eventually give rise to poor productivity, lack of motivation and absenteeism. (ii) Financially literate employees might understand a firm's position better during periods of financial challenge than financially illiterate employees. Better understanding on the part of employees should lead to better outcomes in collective bargaining.

Again, financial literacy also leads to higher returns earned on savings made by the consumer in addition to lower interest generating debt securities. According to Edirisinghi et. al (2017), financial literacy has important consequences for debt related decisions. There is evidence that less financially literate consumers transact in high cost manner and incur higher fees using higher cost borrowing. This could lead to excessive debt and a high probability of credit default.

Edirisinghi et al (2017) goes further to suggest that based on evidence, financial literacy exerts much influence on planning behaviour which increases wealth. Financial literacy also increases the probability of investing in stocks and other diversified portfolio which also leads to increased wealth.

Other benefits of financial literacy as stipulated by CBN (2015) include:

- It enables an individual to make optimal choices in the use of financial products.
- Financial literacy helps in multiple decisions making concerning financial products for individuals, corporate firms and government. There are great diversities of financial products and services and households, firms and government make many financial decisions including budgeting decisions, how much to spend and how much to save. They need to make investment decisions and know how to manage their financial risks. These decisions range in different level of complexity and require a sufficient level of financial literacy to be able to make appropriate decisions.
- It assists in constituting a market for sustainable financial services and products.

- Financial literacy promotes awareness about various financial products/financial instruments such fixed deposits, mutual funds, life assurance, various insurance products, bonds, stocks, forex markets, real estates, debentures , recurring deposits, etc. creating awareness for these financial products through financial literacy creates a robust market for them.
- It encourages lower credit and default risk

With the increased diversity and benefits of financial products and services including debt products, which involve complex risks of various types, with some not being apparent to unwary individuals. Different uncertainties and risk taking capacities require a good level of financial literacy to make adequate financial decisions which will reduce financial risks. Financial literacy bestows adequate knowledge of various debt instruments with their prevailing rates example: personal loans, housing loans, auto loans, etc.

- Good knowledge of financial market performance

Financial literacy enables one to gain adequate knowledge of the highs and lows of the financial markets. It aids the understanding of changes and movements of the market, the reasons why they occur and the consequences of such changes on individuals and the entire economy. Having a good knowledge of trends in the global market, prediction of movement in the market and their significance i.e. gains or losses, helps individuals and organizations to make good investment decisions.

- It promotes financial system stability by increasing the demand and responsible use of financial services.

4. EFFECTS OF FINANCIAL LITERACY ON DIFFERENT ECONOMIC SEGMENTS OF THE SOCIETY.

Financial literacy conveys different effects on different classes of the society. The impact of financial literacy varies from one individual to another depending of the economic segment of those involved. All participants of the financial system are required to have a basic level of financial literacy.

- **Low Economic Resource Group** – Many, within this segment of the population still store cash at home and resort to moneylenders, borrowing at exorbitant interest rates. Financial literacy within this segment teaches the benefits of being part of the financial system, knowing how to manage fluctuations in income, handling unexpected emergencies without being trapped in unnecessary debt.

- **Middle Economic Resource Group** – Majority in this segment are already financially included i.e. they have access to financial products and participate in financial markets as savers or borrowers. Efforts on financial literacy should be channelled towards increasing their knowledge of new products and services. Example: many in this segment may operate regular savings, current account in banks but fail to participate in the capital market due to ignorance in that aspect of finance. In that case, financial literacy to this class of people should be centred on teaching about the operation and benefits of the stock market encouraging them to invest and earn higher returns from the market.

- **High Income Group** – To these groups of people, financial literacy should centre on deeper knowledge of the operations, creating awareness about new products. This will enable them to avail themselves of greater benefits from their investments due to investing in innovative products that yield higher returns as well as taking up facilities that come at cheaper rates. Financial literacy should also create awareness to this group that higher returns also imply higher risk.

5. SOME POLICY OPTIONS FOR DEVELOPMENT

A report by the Organization for Economic Co-operation and Development (OECD) defined financial education as “the process by which consumers and investors enhance their level of understanding of financial concepts, financial risks, financial products and financial services. This is usually achieved through instructions, objective advice and general financial information. Financial literacy plays a prominent role and occupies a centre-stage in the quest to achieve financial stability, financial inclusion, economic growth and development. Essentially, to enhance inclusive growth and development in the economy:

1. There is need for the government to evolve relevant policies that will encourage the larger proportion of the population to participate in financial markets activities by expanding the various platforms for financial education.
2. There is a need for financial institutions to constantly improve on their level of financial information available to the society. Such high level of financial information will increase their literacy and enable them gain a better understanding of the risks involved in financial businesses and investments. When customers gain adequate knowledge of investment, they contribute more to the process of growth and development. Interestingly, the report of the 2014 National Baseline survey on Financial Literacy showed that there is a lack of knowledge of several banking products and services among the consumers in the market place. This trend needs to be reversed for the country to experience sustainable growth and development.
3. Policy makers should support the masses and small businesses by creating a conducive environment for the stability of financial markets and institutions. When the financial markets are stable they will be well positioned to lend to Small and Medium Scale Entrepreneurship who will

further contribute employment generation, economic growth and development.

4. For the citizens to contribute meaningfully to the process of development through their involvement in various economic activities, there is need to boost their confidence and trust in the financial sector. To achieve this, financial education must incorporate elements of instilling trust in institutions. People must be made to believe and trust the programs of financial institutions aimed at enhancing the savings and investment capabilities of the populace.
5. Finally, financial education should also be coupled with basic economic literacy and other important life skills such as entrepreneurship training. A major part of the financial education process lies on the Nigerian educational system but unfortunately the sector is faced with several challenges which have limited effectiveness of that system as a channel for reaching the young people in the society. Therefore, there is need for high effective polices to be enacted in order to revamp the education system and this should involve the collaboration of the national, state and local level educational authorities. When the education system is functioning optimally, it will definitely add to the development strides of the nation.

CONCLUSION

The importance of financial education and financial literacy at all levels of the nation's socio-economic strata cannot be overemphasized in view of its enormous benefits. The successful implementation of the financial literacy program would guarantee the future economic and social well-being of Nigerians by reducing poverty, improving income and facilitating development. It would also enable Nigeria to take advantage of global financial dynamics, enhance efficiency in managing personal finances, promote entrepreneurship, banking culture and ultimately ensure financial stability. This paper has explained the concept of financial literacy as a vehicle to economic development in Nigeria. Adequate knowledge of finance is needed for individuals to function properly in the area of economic decision making. Financial knowledge is neither a luxury nor a matter of convenience. Rather it has become an integral tool of survival. This is due to the fact that the lack or low levels of financial knowledge could lead to the choice and implementation of poor financial decisions which could be injurious to individuals and the entire society. It is against this background that this paper argues that the promotion of financial literacy by financial institutions affect users of financial products and services in a positive manner. The paper concludes that financial literacy encourages financial access and savings which invariably increases economic growth, reduces poverty levels, enhance livelihoods and leads to overall economic development.

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