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Financial Literacy Explicated: A Case for Clearer Definition in an Increasingly Complex Economy

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“Improving Financial Literacy and Reshaping Financial Behavior” Conference
Networks Financial Institute at Indiana State University

May 14, 2009



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The Fundamental Research Problem:

There is not a consistent way to define financial literacy or how to measure it.



Today's Topics:

- **The Case for Clarity in Research**
 - Existing Conceptual Definitions
(What is Financial Literacy?)
 - Existing Operational Values
(How Should Financial Literacy Be Measured?)
- **Consistent Definition and Values**



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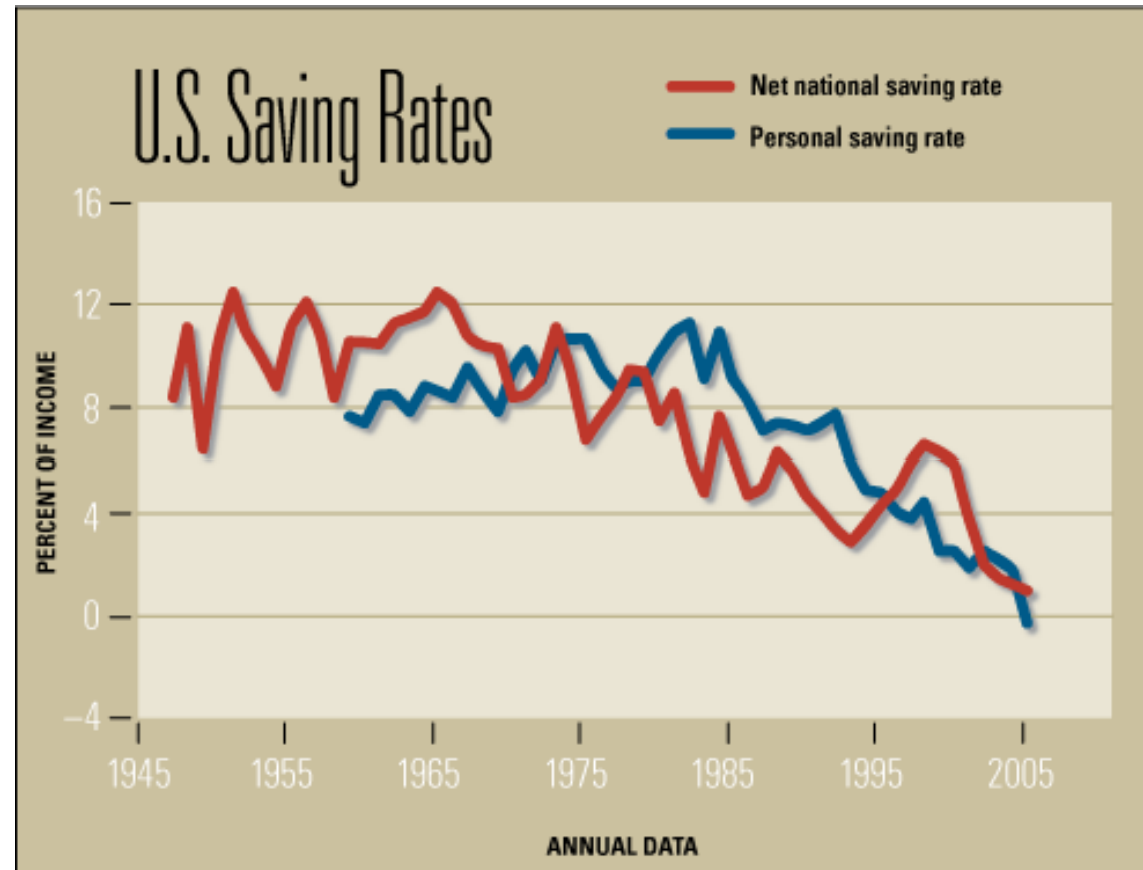
The Case for Clarity in Financial Literacy Research



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Americans
are getting
worse at
managing
their
money...



Source: Federal Reserve Bank of St. Louis, 2006.



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... despite the
best efforts of
many experts.





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Where Research Often Begins:

Financial literacy improves money management – either knowledge, behavior or possibly both.



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Where Research Efforts Tend to Splinter:

- What is financial literacy?
- How should financial literacy be measured?



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Existing Conceptual Definitions: *What is Financial Literacy?*



Some experts use unique definitions...

- Protecting against fraud (FL&EC, 2003)
- Responding competently to life events (Orton, 2007)
- Managing debt (Stone, 2008)
- Understanding how the world works (FFL, 2008)

... or they provide no definition at all.



Some don't even call it financial literacy:

- Financial knowledge
- Financial capability
- Financial self-sufficiency
- Money sense
- Money management skills
- Credit literacy
- Economic literacy
- Empowerment
- Responsibilization



Common Definitions of Financial Literacy

1. Knowledge of financial concepts
2. Ability to communicate about finances
3. Aptitude in managing personal finances
4. Skill in making financial decisions
5. Confidence to plan effectively



Knowledge of financial concepts

- Translation: Having some basic sense of money matters
- Example: “Understanding the basic tenets of sound financial health” (NFCC, 2008)



Ability to communicate about finances

- Translation: Being able to talk with some degree of intelligence about money
- Example: “Becoming a questioning and informed consumer” (Fox, 2005)



Aptitude in managing personal finances

- Translation: Being able to keep track of money, use a bank account, etc.
- Example: “Ability to manage personal finances” (Chen, 2002)



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Skill in making financial decisions

1. Translation: Being able to make smart short-term choices with money.
2. Example: “Successful financial decision-making” (Jump\$start, 2008)



Confidence to plan effectively

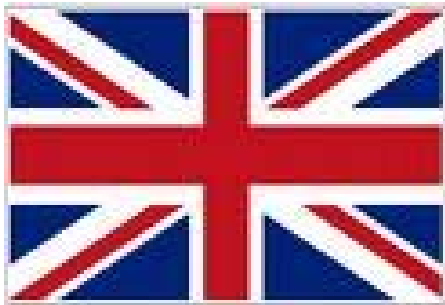
- Translation: Having the knowledge, skill and self-discipline to make long-range financial decisions
- Example: “Responsible saving habits for future retirement” (Wi\$eUp, 2008)



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International Alignment with Common American Definitions





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Existing Operational Values:
*How Should Financial Literacy Be
Measured?*



Most experts use surveys and polls in gauging financial literacy...

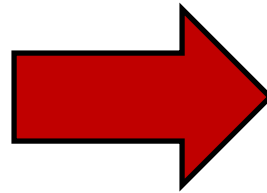
... but the operational definitions and values vary significantly.



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*Conceptual
Definition:
General
Knowledge or
Awareness of
Financial Matters*



*Operational
Definition:
Aptitude in
Managing Specific
Aspects of Personal
Finance*



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Common Operational Definitions:

- Budgeting
- Saving
- Borrowing
- Investing



Operational Values of Financial Literacy

Average composite scores:

- Students: 48 to 52 percent
- Adults: 53 to 81 percent



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Operational Values of Financial Literacy:

Range of variable-specific scores:

- Adults: 12 to 87 percent



Operational Values of Financial Literacy:

Range of positive impact from outreach:

- 8 to 20+ percent



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Putting It All Together:
*Consistent Definition and Values for
Future Research*



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Conceptual Definition

Financial literacy is a measure ...



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Conceptual Definition

Financial literacy is a measure of the degree to which one understands key financial concepts ...



Conceptual Definition

Financial literacy is a measure of the degree to which one understands key financial concepts – namely budgeting, saving, borrowing and investing...



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Conceptual Definition

Financial literacy is a measure of the degree to which one understands key financial concepts – namely budgeting, saving, borrowing and investing – **and possesses the ability and confidence to manage personal finances ...**



Conceptual Definition

Financial literacy is a measure of the degree to which one understands key financial concepts – namely budgeting, saving, borrowing and investing – and possesses the ability and confidence to manage personal finances **through appropriate short-term decision-making and sound, long-range financial planning ...**



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Conceptual Definition

Financial literacy is a measure of the degree to which one understands key financial concepts – namely budgeting, saving, borrowing and investing – 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.**



Operational Values of Financial Literacy

Average Composite Score:

- Students – At least 48 percent
- Adults – At least 53 percent

Anticipated Benefit of Outreach:

- Gain of at least 8 percent



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