

Impact of Financial Literacy and Financial Planning on Individual Economic Stability

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Abstract

Financial literacy, the ability and efficiency to understand and manage personal finances, empowers individuals to make informed decisions that can significantly impact their financial security and overall quality of life. This paper aims to investigate the role of financial literacy and financial planning in enhancing economic stability among individuals. It analyses the financial knowledge, level of awareness and financial planning practices among individuals and how these factors contribute towards economic stability. The study conducted using primary data collected through questionnaire. The study highlights that financial literacy leads to economic stability only when there is proper financial planning among individuals. The paper concludes by understanding financial concepts, making informed decisions, and adopting responsible financial habits, individuals can build a strong financial foundation.

Keywords: Financial Literacy, Economic Stability, Financial Planning, Financial education,

1. Introduction

Financial literacy is the ability to understand and manage personal finances effectively to empower individuals to take financial decisions wisely. It empowers individuals to take better decisions in budgeting, debt management, savings and investment also. Financial literacy comprises a wide range of knowledge, skills, attitude, behaviour that enable an individual to choose various financial products and services. In today's complex and rapidly changing financial landscape, individuals face numerous challenges to manage their finance. This creates a need for financial literacy among individuals. Financial literacy is not only essential for personal financial well-being but also for economic stability and growth.

Financial planning, one of the outcomes of financial literacy, involves the process of setting financial goals, assessing financial resources, and develop strategies to achieve financial objectives. Financial planning includes a range of activities, including budgeting, saving, investing, and managing risk. Financial planning helps individuals to create emergency funds, diversify income streams, and manage financial risks, and also helps to reduce the financial shocks and instability. Financial literacy also promotes long-term planning, budgeting, and cash flow management, enabling individuals to achieve financial stability and security. By empowering individuals with financial knowledge and skills, financial literacy plays a major role in promoting economic stability and resilience.

This paper analyses the financial literacy level of individuals and examines the relationship between financial literacy and economic stability. This paper also studies the mediating role of financial planning in between the relationship of financial literacy and economic stability.

2. Review of Literature

The researcher conducted an extensive review on financial literacy, economic stability and financial planning. As a part of the review, the following classifications are made namely;

2.1. *Role of Financial Literacy on Economic Stability*

Shingrup (2020) has examined the importance of the financial literacy for the financial stability in the society. This study highlights the significance of financial literacy in achieving financial stability in society. Financial literacy enables individuals to make informed financial decisions, promotes financial inclusion, and fosters a culture of saving, investment, and financial planning. It provides individuals with the knowledge and skills necessary to navigate complex financial markets, utilize financial services effectively, and secure their financial well-being. Ultimately, financial literacy plays a crucial role in sound financial management and is essential for achieving financial stability and security.

Katnic et al., (2024) The article explores the relationship between financial literacy and economic stability in Montenegro, a small emerging economy. The study employs a quantitative approach to explore the association between financial literacy levels and measures of economic stability, including savings rates, active debt management, and access to financial products using a survey-based methodology to collect data from a representative sample of 1000 Montenegrin adults. The findings suggest that higher levels of financial literacy are associated with better financial practices, such as increased savings and responsible credit use, thereby enhancing economic resilience at the household level. The findings also suggests that financial literacy can mitigate the impact of economic shocks, emphasizing the need for policies that promote financial education as a tool for sustainable development.

2.2 *Role of Financial Planning on Economic Stability*

Thianboonsong, & Marin (2023) contributes to the existing literature on financial planning and literacy, highlighting the importance of financial knowledge and discipline in achieving financial objectives, especially on young adults. The findings emphasize the significance of financial literacy in promoting economic stability and resilience. The study's focus on Royal Thai naval cadets provides a unique perspective on the financial planning behaviours of young adults in a military context, adding to the growing body of research on financial literacy and planning among specific populations. Overall, the study's emphasis on the importance of financial knowledge and discipline in preventing overspending and promoting financial stability resonates with the broader literature on financial literacy and planning.

Addition to this, Cagay, R. (2020) examined the relationship between financial planning and stability among 50 night market vendors in Panabo. The purpose of this study is to analyse the correlation or significant relationship between financial planning and stability. The study concludes that financial planning has a significant impact on the stability of night market vendors.

2.3 *Research Gap*

Despite the growing body of research on financial literacy and financial planning, there are still gaps in the literature. More research is needed to explore the impact of financial literacy and financial planning on economic stability in diverse populations and contexts. Future research could employ longitudinal designs to examine the causal relationships between financial literacy, financial planning, and financial outcomes over time. Additionally, further study is required to develop effective interventions and programs that promote financial literacy and financial planning.

3. Statement of the Problem

The widespread lack of financial literacy and effective financial planning strategies among individuals and communities poses a significant threat to economic stability. This knowledge gap leads to poor financial decision-making, resulting in increased debt, reduced financial well-being, and a heightened vulnerability to financial shocks. Furthermore, the inability to effectively manage finances creates a fear of financial insecurity, limiting opportunities for economic mobility and income inequality. High levels of debt and financial distress, limited access to credit and financial services, inadequate savings and retirement planning, and increased vulnerability to financial scams and exploitation are the far-reaching consequences of this problem. The lack of financial literacy and effective financial planning strategies represents a critical problem that demands attention and action from policymakers, educators, and financial professionals. This study aims to investigate the impact of financial literacy on economic stability among individuals and explore the mediating role of financial planning in this relationship, with a view to informing the development of effective financial education and planning initiatives.

4. Objectives

- Analyze the impact of financial literacy on economic stability among individuals
- To study the mediating role of financial planning in between the financial literacy and economic stability

5. Analysis and Interpretation

This area covers analysis and interpretation of data to assess the impact of Financial Literacy on Economic Stability and how far Financial Planning mediates in that relationship. As a part of this, Structural Equation Modeling was adopted.

5.1 Impact of Financial Literacy on Economic Stability

This section deals with the evaluation of the impact of financial literacy on economic stability. For that, Structural Equation Modeling was adopted and the following hypothesis was proposed.

H1: Financial Literacy exerts significant impact on Economic Stability

Figure No 1 illustrates the Structural Equation Model on the Impact of Financial Literacy on Economic Stability

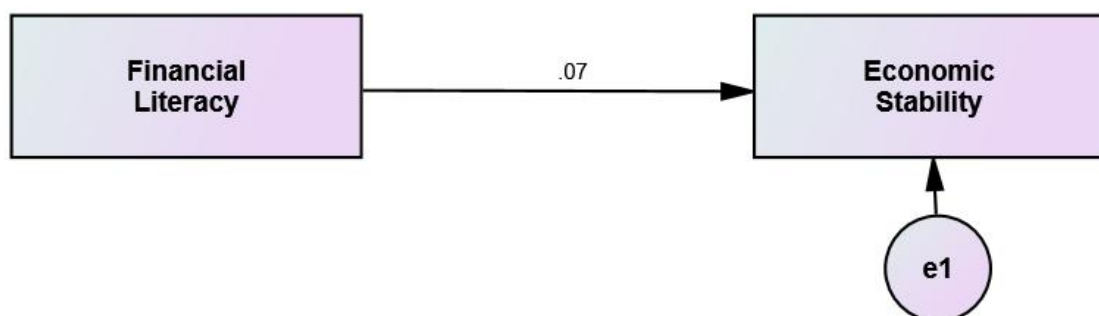


Figure No 1

Structural Equation Model on the Impact of Financial Literacy on Economic Stability

Table No. 1 demonstrates the coefficient of the impact of Financial Literacy on Economic Stability.

Table No 1
Impact of Financial Literacy on Economic Stability - Coefficient

Factors			Coefficient	S.E	C.R	P	Decision
Financial Literacy	→	Economic Stability	0.073	0.082	0.897	0.212	H1 Not Supported

As per the results, it can be inferred that financial literacy does not posses any sort of impact on economic stability of individual as the coefficient value is not significant at 1 % or 5 % level. So, the hypothesis is not supported.

Table No 2
Impact of Financial Literacy on Economic Stability - Model Fit Indices

Indices	Value	Fit Criteria
CMIN/DF	2.172	< 5 (Hair et al., 1998)
GFI (Goodness of Fit Index)	0.993	> 0.90 (Hu & Bentler, 1999)
AGFI (Adjusted Goodness of Fit Index)	0.974	> 0.90 (Hair et al., 2006)
NFI (Normed Fit index)	0.985	> 0.90 (Hu & Bentler, 1999)
CFI (Comparative Fit Index)	0.992	> 0.90 (Hooper et al., 2008)
RMR (Root Mean Square Residual)	0.022	< 0.08 (Hair et al., 2006)
RMSEA (Root Mean Square Error of Approximation)	0.039	< 0.08 (Hair et al., 2006)

From **Table No. 2**, it is evident that the model indicating the impact of financial literacy on Economic Stability is fit with all the model fit indices such as CMIN/DF, Goodness of Fit Index, Adjusted Goodness of Fit Index, Normed Fit index, Comparative Fit Index, Root Mean Square Residual and Root Mean Square Error of Approximation.

5.2 Impact of Financial Literacy on Economic Stability with Financial Planning as Mediating Variable

While testing the impact of Financial Literacy on Economic Stability, it is proven that both factors are not related. So, this section evaluates the extent to which Financial Planning mediates in between Financial Literacy and Economic Stability. For this, the given hypothesis is proposed.

H2: Financial Planning significantly mediates the relationship between Financial Literacy and Economic Stability

Figure No 2 illustrates the Structural Equation Model on the Impact of Financial Literacy on Economic Stability with Financial Planning as Mediating Variable

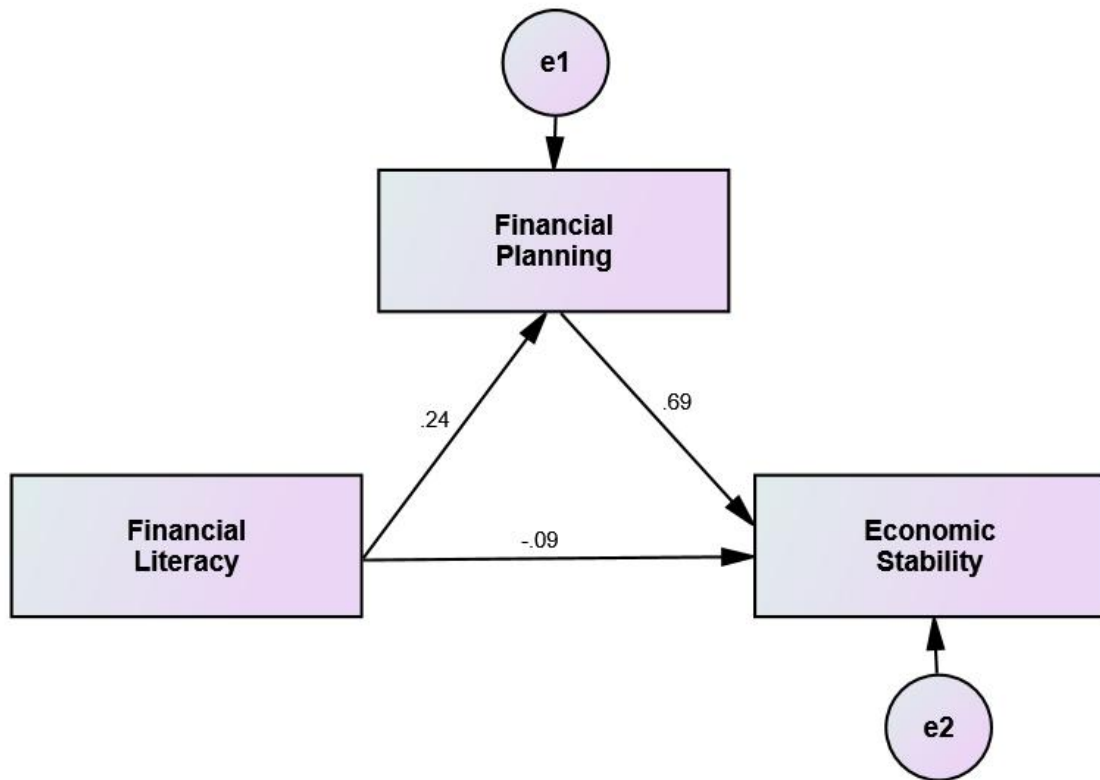


Figure No 2
Structural Equation Model on the Impact of Financial Literacy on Economic Stability with Financial Planning as Mediating Variable

Total, Direct and Indirect Effects of the Impact of Financial Literacy on Economic Stability with Financial Planning as Mediating Variable is depicted in **Table No 3**

Table No 3
Impact of Financial Literacy on Economic Stability with Financial Planning as Mediating Variable - Total, Direct and Indirect Effects

	Coefficient	P	Result	Decision	Nature of Mediation
Total Effect	0.073	0.212	Insignificant	H ₂ Supported	Full Mediation
Direct Effect	-0.093	0.164	Insignificant		
Indirect Effect	0.166	0.018*	Significant		

* **Significant at 5% level**

Results of Mediation Analysis show that Financial Planning exerts a full mediation effect in between Financial Literacy and Economic Stability of individuals. Both Total and Direct Effects are found to be insignificant. However, when the mediating variable Financial Planning is introduced into the model, the relationship becomes significant statistically.

Thus, it can be drawn that Financial Literacy among individuals leads to Economic Stability only when there is proper Financial Planning among them is present.

Table No 4
Impact of Financial Literacy on Economic Stability with Financial Planning as Mediating Variable - Model Fit Indices

Indices	Value	Fit Criteria
CMIN/DF	1.834	< 5 (Hair et al., 1998)
GFI (Goodness of Fit Index)	0.987	> 0.90 (Hu & Bentler, 1999)
AGFI (Adjusted of Goodness of Fit Index)	0.953	> 0.90 (Hair et al., 2006)
NFI (Normal Fit index)	0.967	> 0.90 (Hu & Bentler, 1999)
CFI (Comparative Fit Index)	0.977	> 0.90 (Hooper et al., 2008)
RMR (Root Mean Square Residual)	0.018	< 0.08 (Hair et al., 2006)
RMSEA (Root Mean Square Error of Approximation)	0.029	< 0.08 (Hair et al., 2006)

Table No. 4 evidenced that the model indicating the relationship between the Financial Literacy and Economic Stability with Financial Planning as mediating variable is capable to represent what it intends to represent as all the model fit indices such as CMIN/DF, GFI, AGFI, NFI, CFI, RMR and RMSEA have secured the criteria.

6. Discussion and Implication

Financial Literacy enables individuals to make informed financial decisions, such as planning budgets, save for emergencies and invest for the future. So, this would lead to better financial stability, by doing so individuals are equipped with managing their debts and financial shocks efficiently. Financial Literacy fosters the culture of savings, reduces Financial Stress, promotes Financial Inclusion and Financial Resilience and enables individuals to make better informed decisions about credit and debt.

Financial Literacy is a crucial factor in promoting economic stability among individuals and its impact is significantly enhanced through the mediating role of Financial Planning. Financial Planning helps individuals to prioritize their financial goals, allocate financial resources efficiently, and make informed decisions about investment, management of debt etc. By creating a comprehensive Financial Plan, individuals can identify the financial risk and can also take proactive measures to mitigate that.

Financial Literacy promotes financial education and awareness but financial planning helps to translate this knowledge into actionable strategies that foster financial stability. So, Financial Planning act as a bridge between Financial Planning and Economic Stability.in conclusion, by fostering a culture of Financial Literacy and Financial Planning, individuals can make informed financial decisions.

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