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The Impact of Financial Literacy on Perceiving The Need to Create an Emergency Fund

Abstract. Introduction. This study examines the intersection of financial literacy and emergency fund preparedness, with a focus on adhering to personal finance guidelines during turbulent economic times.

Purpose. The primary objective is to identify factors that influence households' perceptions of emergency funds. The study examines the impact of financial literacy on individuals' perceived need for emergency funds, addressing gaps in the literature and contributing to interventions to improve financial well-being.

Results. The findings highlighted the core dimensions of financial literacy and addressed the lack of a universally accepted definition. Five key dimensions were identified: knowledge of financial concepts, financial communication skills, ability to manage personal funds, ability to make wise financial decisions, and confidence to effectively plan for future financial needs by establishing an emergency fund. A notable discrepancy between individuals' financial knowledge and confidence is demonstrated, underscoring the need for interventions that address both. The study highlights the importance of bridging the knowledge gap and addressing subjective perceptions for overall financial well-being. Demographic nuances indicate different levels of preparedness for an emergency fund among different groups, calling for tailored financial education initiatives. Recommendations include longitudinal studies, comparative analyses across socio-economic contexts, and evaluations of the effectiveness of financial literacy interventions.

Conclusions. Fostering robust financial literacy emerges not only as a means to navigate financial complexities with different strategies, including the establishment of emergency funds, but also as a transformative force for achieving individual financial prosperity, shaping interventions for financial well-being.

Keywords: financial literacy; financial planning; emergency funding; financial decision-making; emergency fund allocation.

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Вплив рівня фінансової грамотності на сприйняття необхідності заощаджень на невідкладні ситуації

Анотація. У цій роботі досліджено взаємозв'язок між фінансовою грамотністю та фінансовою готовністю до невідкладних ситуацій в у періоді економічних потрясінь. Основна мета роботи полягає у визначенні факторів, що впливають на сприйняття домогосподарствами заощаджень на випадок надзвичайних ситуацій. Було проведено дослідження впливу рівня фінансової грамотності на необхідну кількість заощаджень. Цим самим було заповнено прогалини в літературі та прокладено шлях інтервенціям, спрямованим на покращення фінансового добробуту. Результати дослідження показали на відсутність загальноприйнятого визначення «фінансової грамотності». У зв'язку з цим було виокремлено п'ять основних вимірів фінансової грамотності, як-от: знання фінансових концепцій, вміння комунікувати про фінанси, здатність управляти власними коштами, вміння приймати мудрі фінансові рішення та впевненість в ефективному плануванні майбутніх фінансових потреб за допомогою екстреного фінансування. Було виявлено значну розбіжність між фінансовими знаннями та впевненістю людей у собі й власних фінансових спроможностях, що підкреслює необхідність втручання, спрямованих на обидва аспекти. Дослідження підкреслює важливість подолання розриву в знаннях та суб'єктивного сприйняття індивідуального загального фінансового добробуту. Демографічні нюанси вказують на різний рівень готовності різних груп населення, що спонукає до розробки індивідуальних ініціатив з фінансової грамотності. Рекомендації передбачають проведення комплексних часових досліджень, порівняльних аналізів у різних соціально-економічних контекстах та оцінку ефективності інтервенцій.

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Сприяння підвищенню фінансової грамотності є не лише засобом, що допомагає людям зорієнтуватися у випадку настання фінансової скрути у надзвичайній ситуації, але й трансформаційною силою для досягнення індивідуального фінансового процвітання. При цьому це одночасно формує шляхи для інтервенцій для досягнення фінансового добробуту.

Ключові слова: фінансова освіта; фінансове планування; фінансування непередбачуваних обставин; фінансові рішення; екстрене фінансове забезпечення.

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Formulation of the problem. In the realm of personal finance, the advice of financial educators has resonated for decades, urging households to establish and maintain an emergency fund. This advice, which stems from the findings of Johnson and Widdows in 1985, is often challenged during periods of economic prosperity, when complacency leads households to underestimate the potential impact of unforeseen emergencies. The stock market decline and record-high unemployment that marked the Great Recession of 2007 serve as a sobering reminder of household financial vulnerability. The question of how many households-impacted by the lingering effects of the Great Recession-are complying with established personal finance recommendations regarding emergency funds becomes critical as we work through the aftermath of this latest economic downturn [8].

Given the inherent unpredictability of life, where events can occur at any time to disrupt income or inflate expenses, the need to prepare for such uncertainties is unmistakable. As a buffer against unexpected medical expenses or a sudden loss of employment, households need to establish and maintain emergency funds. As a kind of financial safety net, an emergency fund enables individuals or households to deal with unforeseen obstacles without suffering the consequences [7].

Despite all the lessons the Great Recession has taught us, new data shows that a large percentage of people are still not adequately prepared for financial emergencies. As Ghribi (2014) points out, citing a Bankrate study, only 40% of households had sufficient emergency funds to cover three months of expenses [3]. This apparent stagnation in savings behavior following the recession prompts a critical examination of the factors that influence the adequacy or inadequacy of household emergency funds. Thus, the central goal of this study is to unravel and understand the determinants associated with households' emergency fund preparedness in the post-recession recovery period.

Therefore, examining the impact of financial literacy on the perceived need to establish an emergency fund is of paramount importance because it sheds light on the complex relationship between individuals' financial knowledge and their preparedness for unforeseen economic challenges. The study's conclusions could potentially direct targeted efforts and improve the financial well-being of various households.

Analysis of recent research and publications. In the area of financial literacy and emergency savings, key studies such as Babiarz and Robb's (2013) "Financial Literacy and Emergency Saving" examine the relationship between financial knowledge and emergency

preparedness. Lee and Hanna's (2022) exploration of overconfidence in "What, me worry? Financial knowledge overconfidence and the perception of emergency fund needs," sheds light on the psychological factors that influence perceived emergency fund needs. Lee and Hanna (2018) contribute insights on the impact of financial literacy in "The Effect of Financial Literacy on Emergency Fund Adequacy." The theoretical foundation for financial literacy is provided by Remund (2010) in "Financial Literacy Explained," which addresses the lack of a precise definition. The Latin American Council of Management Schools 2019 study examines the history of financial literacy principles. Taken together, these studies provide a nuanced understanding of the complex relationship between people's emergency savings habits and their financial literacy.

While these studies provide useful information, more research is needed to fill gaps in the literature, particularly with regard to financial literacy and emergency savings. The purpose of this study is to advance the existing discussion on personal finance and decision-making practices by examining the relationship between financial literacy and the perceived need to establish an emergency fund.

Formulation of research goals. In a dynamic financial landscape characterized by uncertainty and evolving economic paradigms, this research seeks to dissect the multifaceted concept of financial literacy's impact on emergency fund savings. By tracing its historical evolution, assessing its various dimensions, and exploring its intricate interplay with emergency fund decision-making and perceptions, the study aims to unravel the complexities that underlie individuals' financial preparedness. To this end, the following goals were set and achieved:

- To define and conceptualize financial literacy.
- To assess financial literacy dimensions.
- To examine the evolution of the financial literacy concept through research.
- To uncover financial literacy's role in decision-making.
- To explore financial literacy's impact on emergency fund perception.
- To identify patterns in financial literacy.
- To examine the relationship between financial risk tolerance and emergency funds.
- To provide practical insights for financial preparedness.

Outline of the main research material. At its core, financial literacy refers to an individual's ability to manage money wisely. Although the term "financial literacy" is

relatively modern, its conceptual origins date back to the early 1900s, coinciding with the beginning of consumer education research and initiatives in the United States [5]. Assessment of this competency is typically conducted at the individual level and then aggregated within specific demographic cohorts, such as high school students or

individuals with limited financial resources, to provide a broader framework for evaluation.

Extensive research conducted since the beginning of the 21st century reveals many definitions of financial literacy, which can be broadly categorized into five main dimensions [10], as shown in Figure 1.

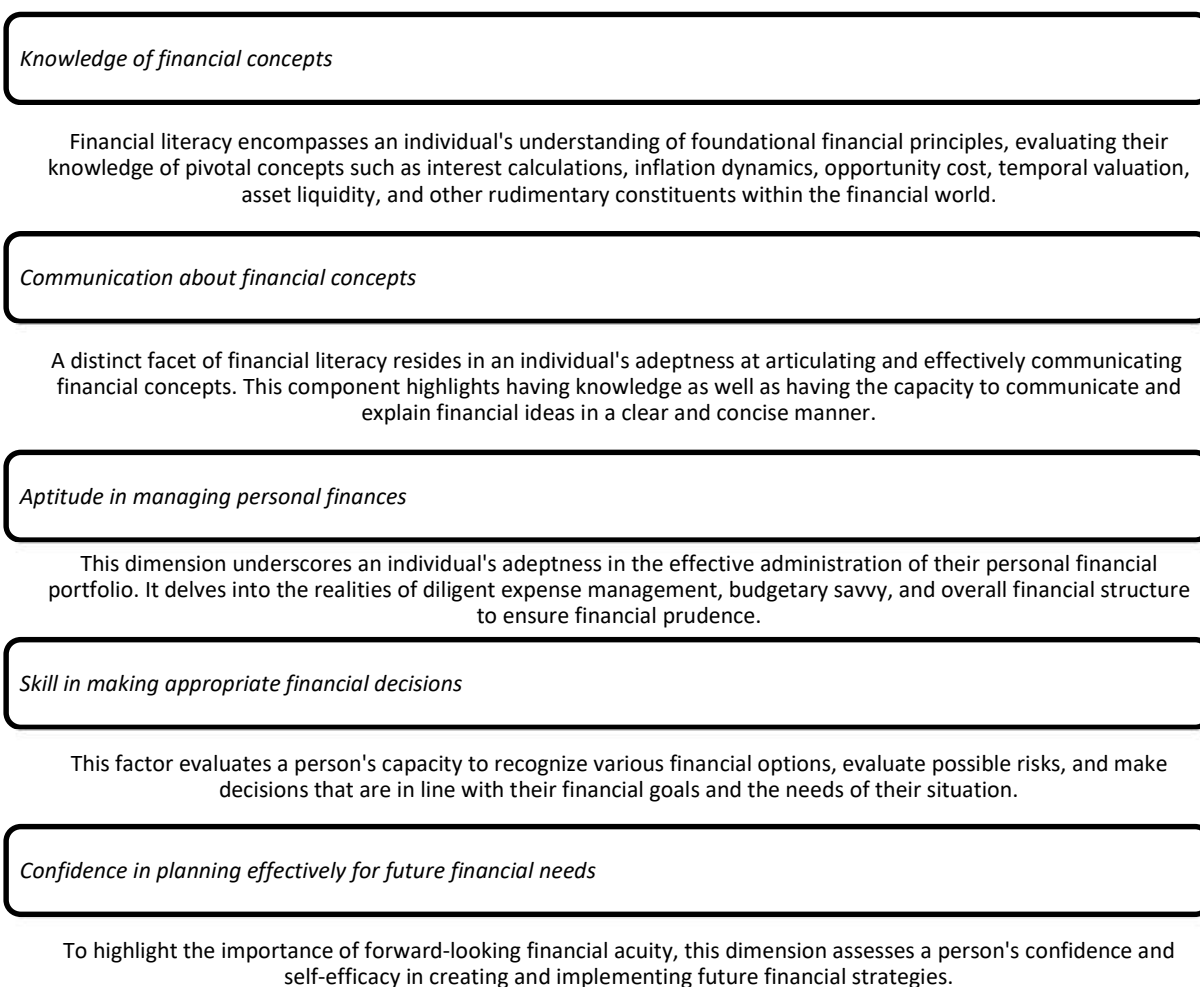


Figure 1 – Five dimensions of financial literacy

Source: [10]

The term "financial literacy" has caused confusion and lacks a universally accepted definition, as noted by various researchers. This lack of a clear and generalizable definition underscores a prevailing challenge in the literature and suggests a need for greater consensus and clarity in understanding the concept of financial literacy [6] (Table 1).

Financial literacy is the foundation of global financial education and plays a central role in shaping individuals' ability to make informed decisions. This interrelated

relationship is underscored by a "meaning-making process" in which individuals use skills, resources and contextual knowledge to navigate the complex landscape of financial decisions and their consequences. The complex concept of financial literacy encompasses important areas such as basic personal finance, risk management, emergency fund management, credit and debt management, saving and investing, and money management.

Table 1 Academic Development of the Financial Literacy Term

Year	Author	Definition
1992	Noctor, Stoney, & Stradling	Ability to make informed judgments and to take effective decisions regarding the use and management of money.

2005	OCDE	The process by which financial consumers or investors improve their understanding of financial products and concepts and, through information, education and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities.
2008	Servon, & Kaestner	Individual's ability to understand and use financial concepts.
2009	Hung, Parker, & Yoong	Knowledge of basic economic and financial concepts and the ability to use this knowledge and other financial skills to manage financial resources effectively for lifelong financial well-being.
2010	Agarwal, Amromin, Ben-David, Chomsisengphet, & Evanoff	Ability to acquire sufficient information about financial concepts and instruments in order to make informed financial decisions.
2010	Remund	Measure of the degree to which one understands key financial concepts and has the ability and confidence to manage personal finances through appropriate short-term decision-making and sound long-term financial planning, taking into account life events and changing economic conditions.
2010	Huston	Financial literacy has an application dimension, which implies that an individual must have the ability and confidence to use his/her financial knowledge to make financial decisions. It has two dimensions: understanding (having sufficient financial knowledge) and application (using that knowledge appropriately).
2011	Cull, & Whitton	It is a broad term and encompasses a basic level of knowledge and skills in areas such as superannuation, taxation, estate planning, home ownership, investments, debt and risk management, pensions and employee benefits.
2012	Vieira	Ability to understand matters of financial nature, consisting of the set of skills and knowledge that allows an individual to make informed and effective decisions through their understanding of finances.
2012	Atkinson, A. F., & Messy, F.	The combination of awareness, knowledge, skills, attitudes and behaviors necessary to make sound financial decisions and ultimately achieve individual financial well-being.
2013	Bhushan, P. & Medurey, Y.	Helps individuals improve their level of financial literacy, enabling them to process financial information and make informed decisions about their personal finances.
2013	Hastings, J.S., Madrian, B.C., & Skimmyhorn, W.L.	The term has taken on a variety of meanings; it has been used to refer to knowledge of financial products (e.g., the definition of a stock and a bond, the difference between a fixed-rate and an adjustable-rate mortgage), knowledge of financial concepts (inflation, compounding, diversification, credit scores), mathematical or numerical skills needed to make effective financial decisions, and engagement in specific activities such as financial planning.
2014	Abdullah, M., & Chong, R.	Ability to make effective decisions regarding the use and management of money and other assets.
2014	Lusardi, A. & Mitchell, O.	Individuals' ability to process economic information and make informed decisions about financial planning, wealth accumulation, debt, and pensions.
2015	Deepak, C. A., Singh, P., & Kumar, A.	Financial literacy provides consumers with the knowledge and skills necessary to assess the suitability of various financial products and investments available in the financial marketplace. This benefits consumers and translates into benefits for the economy as a whole. Financial literacy is primarily about empowering and educating consumers to learn about finance in a way that is relevant to their lives and to use that knowledge to evaluate products and make informed decisions.
2015	Kimiyaghalam, F., & Safari, M.	A person's competence in money management.
2017	Cichowicz, E. & Nowak, A.	Individuals' financial knowledge and skills, and their attitudes and behaviors toward changes in the financial environment.
2017	Okello Candiya Bongomin, G., Mpeera Ntayi, J., Munene, J. C., & Akol Malinga, C.	Ability to obtain, understand and evaluate the relevant information necessary to make financial decisions and choices with an awareness of the likely financial consequences.
2018	Amagir, A., Groot, W., Van Den Brink, H., & Wilschut, A.	Ways in which individuals understand, manage, and plan their personal finances. The definition includes knowing what to do, having the skills to do it, and having the inclination to do it.

Source: [6]

Basic personal finance extends beyond mere financial understanding, delving into essential concepts within the financial system. Meanwhile, money management focuses on the nuanced art of personal financial stewardship, teaching individuals how to effectively manage their monetary resources. Credit and debt

management intricately interweaves activities related to bank loans, emphasizing a systematic approach to repayment. Saving delineates a portion of income reserved for future use, while investing involves the strategic use of those savings for economically beneficial

activities, coupled with a keen awareness of the risks associated with uncertainty.

The broad scope of financial literacy extends to critical areas such as spending and credit, insurance, and saving and investing. Developing a meticulous spending plan and sticking to it are essential to avoiding financial deficits. The prudent use of credit as a sound financial tool, rather than excess cash to indulge desires, underscores the importance of responsible financial behavior. In the face of escalating financial uncertainty, insurance takes on greater importance, providing a safety net by guaranteeing compensation for unforeseen losses. The concept of saving is not only about short-term consumption security, but also a cornerstone of sound financial planning.

Recognizing financial literacy as an essential need becomes paramount to averting financial difficulties. Beyond the confines of income levels, financial challenges can arise from mismanagement, credit abuse, and a lack of comprehensive financial planning. The impact of these challenges extends beyond monetary concerns, contributing to increased stress levels and diminished self-esteem [2].

Consistent with this urgency, findings from Bankrate's Annual Emergency Fund Report highlight the prevailing concerns. The report reveals that 68% of people express concern about being able to cover their living expenses for just one month if they lost their primary source of income. This concern is particularly pronounced as 57% of U.S. adults currently cannot afford to cover a \$1,000 emergency expense [4].

Delving into generational perspectives, it is clear that younger demographics, such as Gen Zers (85%) and Millennials (79%), exhibit heightened concerns about covering unforeseen expenses. This interconnected web of financial challenges across age groups underscores the critical need for widespread financial education to empower individuals to effectively navigate and overcome these concerns [4].

The interplay between financial literacy and the perceived need for an emergency fund is complex. Statistics reveal a landscape where only about 38% of respondents reported having an adequate emergency fund. This finding underscores a critical gap in financial preparedness and echoes concerns about the general lack of emergency savings among individuals.

The respondents' performance on the financial literacy test illustrates the challenges. On average, respondents scored 60%, revealing significant room for improvement in financial literacy.

One of the most interesting findings relates to the paradox between people's objective financial knowledge and their subjective confidence in their financial understanding. Despite moderate levels of financial literacy, a significant proportion of people expressed high levels of confidence in their financial knowledge. This discrepancy highlights the importance of addressing not only the actual financial literacy gap, but also the

subjective perceptions individuals have about their financial acumen.

Looking at demographic patterns, key characteristics associated with individuals who have established an emergency fund have been identified. Older individuals, males, those with higher levels of education, those who are married, and those who are employed or retired are more likely to have emergency savings. These demographic nuances suggest that targeted financial education interventions may be more effective when tailored to the specific needs and characteristics of different demographic groups.

Additionally, a correlation was found between financial risk tolerance and the presence of an emergency fund. Individuals with established emergency savings had slightly higher financial risk tolerance. This finding suggests a complex interplay between risk attitudes and financial preparedness, and warrants further exploration of how individuals' perceptions of financial risk influence their decisions to establish and maintain emergency funds [1].

Given the increasing prevalence of financial uncertainty, understanding how to secure emergency funds is critical. It's important to consider options such as creating an emergency fund, thinking about other sources of income, and evaluating the financial assistance programs that are available. This comprehensive strategy dovetails with the overarching goal of improving financial literacy, as people who know how to manage and save for emergencies are better equipped to deal with unforeseen financial difficulties.

When faced with urgent financial needs, individuals can explore various options to obtain emergency funds promptly. Small personal loans, available through traditional banks or alternative lenders, serve as a viable solution for short-term financial needs. These unsecured loans serve various purposes, from debt consolidation to unexpected expenses, with fixed interest rates and repayment terms. However, the application process can be time-consuming and require extensive paperwork.

Another option is to use credit cards, especially for those with existing cards that offer instant approval. However, this option can come with high interest rates, around 25%, and potential fees. Maintaining a good credit score is critical to securing favorable credit card terms. In addition, individuals can take advantage of pawn shop loans, where personal items such as jewelry or electronics serve as collateral for quick cash. The borrowing process is expedited, and credit score considerations are minimal.

Title loans use the borrower's vehicle as collateral and are a short-term secured option. These loans can be easier to obtain, although they don't require as much paperwork or credit checks. To mitigate potential risks, such as the loss of the collateral, it is imperative to carefully evaluate the borrower's ability to repay. Making informed decisions while navigating financial uncertainty is ensured by comparing partner lenders and researching the best emergency loan solutions [9].

Conclusions. The study began by acknowledging the importance of such funds during periods of economic prosperity. The aftermath of the Great Recession underscored the importance of households adhering to established personal finance guidelines regarding emergency funds. The central goal of the research was to unravel the determinants associated with households' emergency fund allocations.

Based on the objectives and tasks set, the following key findings were identified:

- The study identified five primary dimensions of financial literacy, including substantive financial knowledge, competence in managing personal finances and being able to talk about financial topics, ability to make wise financial decisions, and confidence in effectively planning for future financial needs with emergency funds.

- The lack of a commonly accepted definition of financial literacy contributes to a persistent problem in the literature. The study underscores the need for greater agreement and clarity by highlighting how the concept of financial literacy has changed over time.

- A comprehensive examination of the relationship between financial literacy and the perceived need for an emergency fund revealed a significant shortfall in financial preparedness. Just over 38% of respondents reported having enough money saved for emergencies, suggesting that their financial literacy could use some work.

- Demographic nuances identified key characteristics associated with individuals who have established emergency funds. Older individuals, males, those with higher levels of education, those who are married, and those who are employed or retired showed higher levels of preparedness.

- The study revealed a relationship between financial risk tolerance and the presence of an emergency fund. Individuals with established emergency savings had slightly higher financial risk tolerance, suggesting a complex interplay between risk attitudes and financial preparedness.

- The study underscores the importance of addressing both the actual financial knowledge gap and

the subjective perceptions individuals have about their financial acumen. Closing this gap is critical to improving overall financial well-being.

- To improve financial preparedness, the study recommended a multi-pronged approach, including building emergency savings funds, considering alternative sources of income, and assessing available financial assistance programs.

- When faced with urgent financial needs, individuals can explore several options, including small personal loans, credit cards, pawn shop loans, and title loans. However, careful consideration of interest rates, repayment terms, and potential risks is essential when choosing these solutions.

Further research could explore longitudinal studies to closely monitor the development of emergency fund readiness and financial literacy over time. A complementary approach is to conduct comparative assessments across different socioeconomic and cultural settings. Given the different dynamics and barriers that people face in different circumstances, this method has the potential to provide a more thorough understanding of the elements that influence emergency fund readiness.

An important area for future study is to assess the effectiveness of specific financial literacy interventions and education initiatives. This evaluation can provide a roadmap for refining and optimizing interventions to ensure they have a meaningful impact on individuals' emergency fund preparedness. By systematically evaluating the effectiveness of different approaches, researchers can contribute to the development of more effective initiatives that resonate with diverse audiences.

Another direction for future research is the integration of technology. Examining the role of technology in disseminating financial education information and facilitating emergency fund management is a relevant and timely research direction. Exploring innovative technologies, such as mobile applications, online platforms, and digital tools, could provide new avenues for delivering financial education and promoting proactive emergency fund practices.

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