Evaluating the Financial Literacy Skill of Undergraduate Students

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We compare different findings, surveys performed, and recommendations made for undergraduate college students to better understand their financial literacy both as an undergraduate and beyond.

Keywords: Financial literacy, undergraduate students, financial planning, saving money

INTRODUCTION

The main problem undergraduate students find in financial literacy, is the inability to adapt to the financial responsibilities of life following graduation. While not all ungraduated students fall into the various traps, those that do can suffer the long-term effects of not having a good, basic financial skills. The financial skills learned, or the lack thereof, typically carry over into their work lives which can have significant effects on their credit rating, borrowing power, the ability to save money for large purchases and for retirement. One survey [1] shows that 32% of employees have zero savings for their retirement. As more and more companies do away with defined benefit plans, it is even more important to gain the financial skills early so that when entering the workforce contributions can be made to the defined contribution plans. Defined benefit plans are more common among state and local government workers, while those in private industry overwhelmingly are left to contribution benefit plans. American employees with defined benefit plans feel more secure about their financial future and they retire 5 to 10 years earlier than employees with a defined contribution benefit. In one study [2] they found that employees contribute 5% on average of their income to their retirement plans. With less defined benefit plans available to employees, having financial freedom increases the importance on personal financial literacy more than ever.

Those that do not have a learned financial strategy frequently fall into the trap of large consumer debt, while only having a small amount of savings and are susceptible to bankruptcies. In [3] it can be seen that the number of personal bankruptcies had two peaks: 2005 (an all-time high) and 2010. In 2005 it was due to the passage of the Bankruptcy Abuse Prevention and Consumer

Protection Act which caused a rush a people to file while it was viewed as having a decent chance of a fresh start. After the passage of the act, it would become significantly more difficult for individuals to file for bankruptcy. The cause of the spike for 2010 was high unemployment, a poor housing market, the wars in the middle east, dept crises in Europe and the United States, large increase in food prices, environmental disasters, and many mortgage foreclosures. Bankruptcies decreased during the COVID19 pandemic largely due to government aid, but personal bankruptcies are on the rise once again.

FINANCIAL EDUCATION

It is somewhat common to see financial training classes at the high school level, but it is not about just learning, but about generalizing these skills across a lifetime of behaviors. Despite the growing prevalence of these courses and learning opportunities, college students still have relatively poor financial management skills and are not fully aware of the topics of loans, credit cards, simple interest rates, inflation, types of investments such as stocks and bonds, and retirement plans. In [2] they followed a study a that showed that those students who took an introductory personal financial management type course did not do any better than those who did not take the course. In the same study they found that 70% of students had reported learning about finances from their parents with students being 30% more likely to actively participate in investments if their parents were investors. The authors in [2] ran a survey of nearly 1500 students at a private university. The results showed that three areas helped in financial literacy: family and background (but not family income level), formal learning including watching the news regularly, experiential learning over their lifetime, with holding a job while in high school being the biggest influencer.

One question is whether starting financial courses earlier than high school grades will help.

The National Association of Student Financial Aid Administrators [4] recommend the following methods: learn to budget by tracking spending and do not spend what you do not have and saving even very small amounts to help build a positive habit.

In [5] they emphasize that a student should study the expected rate of return of their intended field of study with the goal of having students choose a major that can be repaid from employment after graduation.

The average college loan is over $30,000 [6] all while having received over $26,000 in various forms of financial aid. One student benefit that started in 2015 is the 529 savings plan particularly if the student is paying for their own education. By putting money into a 529 savings plan the money is tax deducted from the state income tax. Various state plans have existed prior to 2015. Purdue Global (part of Purdue University) lists six ways to help keep a budget:

1. Determine a time span that you need to budget for.
2. Break down income you will receive over the time span.
3. List your expenses and track your spending.

4. Compare income to expenses.
5. Save money.
6. Revisit your budget and update as expenses shift.

In [7] they perform a survey of financial literacy of first-generation college students. They found that 93% of first-generation students wanted to learn more about finances and the majority would prefer to learn via hands-on in the classroom. They also surveyed industry professionals (financial advisors, independent representatives and bank branch managers) on what they thought or wished would improve. The partial list includes becoming more educated about budgeting, knowing more about saving, become knowledgeable about banking, recognizing that "investing is not a game", what dollar-cost averaging is and the rule of "seventy-two" (how long it will take for an investment to double based on its rate of return).

CONCLUSIONS

Providing a course in financial literacy at the undergraduate degree level is too late many believe. Working at a part-time job at a young age, despite the parents' income, is integral to the establishment of the ability to manage money. It has been my experience that this has had the biggest impact on me over my life. The simple experience of getting a paycheck, cashing it, and then managing it, whether through spending, saving, or both gives you very important real-life hands-on experience.

Encouraging or incentivizing people to enroll into some type of retirement savings plan is another very positive personal impact. There will always be expenses awaiting, but a certain percentage of your money should be deposited into one of the following types of retirement account: IRA, Roth IRA, or 401k. The incentive to depositing the money into these accounts is that there is a significant penalty to withdraw money before retirement which will help keep people from taking from their savings, although 50% of Americans with retirement accounts have taken an early withdrawal [8]. This year I opened Roth IRA accounts for all of my high school aged children and made them an offer to match 50% of what they first deposit in addition to showing them some time series charts on how investments could potentially grow.

For people who do have some type of retirement accounts, I am surprised to find that most times that I speak with someone that they do not know what an expense ratio is and that they might be paying significantly more than they if they switched to a more automated type of fund, like a tracking fund that tracks one of the major financial indexes. The first step is getting people to participate in financial literacy but even if someone does begin to save money they are still not out of the woods. I am still surprised at the number of people who keep their money in a cash account. Many decades ago, this might have a mediocre method of savings but today many savings and checking accounts as well as money market accounts pay between 0 and 2 percent and they are unaware or do not care that their money will typically not beat the rate of inflation.

Becoming financially literate is the first step but it will be a lifelong process as common life events occur and may include college tuition, marriage, raising children, medical expenses, and retirement. Financial literacy will always be required and being able to adapt will be necessary.

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