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Personal Financial Planning on Household Financial Behaviour

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Abstract

Managing a planner's lifetime's financial actions is a key component of personal financial planning. Poor financial planning affects not just an individual's life, but also the lives of their family. It is an important tool for households, as it can help them to make informed financial decisions and achieve their financial goals. This review paper examines the impact of financial planning on household financial behaviour. The findings of the review suggest that financial planning has a favourable impact on household financial behaviour. Households with a financial plan are more likely to have a budget, save for emergencies, and invest for the future. They are also less likely to be in debt. The positive impact of financial planning on household financial behaviour is likely due to a number of factors. First, financial planning can help households to better understand their financial situation and goals. Second, financial planning can help households to develop a roadmap for achieving their financial goals. Third, financial planning can help households to develop financial discipline.

Keywords: *Personal Financial Planning, Household finance, financial behaviour, Investment Decision.*

1. INTRODUCTION

In a world where average income levels are rising, life expectancies are rising, and the financial industry is becoming more complex, financial planning is becoming more and more crucial (Ahmed et al. ,2016). An effective personal financial plan enables someone to pay more attention to how they handle financial matters (Boon, 2011). It serves as a tool for directing financial decisions and emphasising the effects of those decisions on other aspects of one's finances (The Malaysia Financial Planning Council, 2004). Being wealthy may, in the long run, give individual a sense of security and fulfilment, but in the short run, the desired lifestyle and the financial obligations may drain individual of a lot of their resources and pose a serious threat to their ability to live comfortably in their later years (Boon, 2011). Individual must be cautious in this respect when planning what has to be addressed and create a realistic schedule for when their financial goals and objectives are to be accomplished. Such an effort would unavoidably provide individual a strong sense of security and complete financial freedom (Cheah, et al. 1998). Making financial and economic decisions requires using our financial knowledge and skills, which is what personal finance management entails (Refera et al., 2015). In an effort to increase their residents' financial security over the past ten years, numerous governments have established national financial literacy policies (Farrell, L., Fry, T. R., & Risse, L., 2016).

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Understanding how families make financial decisions is crucial for scholars, practitioners, and policymakers. Numerous papers in household finance investigate the determinants of household planning (Campbell 2006; Cardak and Wilkins 2009; Guiso, Jappelli, and Terlizzese 1996; Polkovnichenko 2005); the findings show that household investment behaviour varies with demographic characteristics as well as different levels of wealth, risk tolerance, and financial literacy (Hochguertel 2003; Rosen and Wu 2004; Shum and Faig 2006; Van Rooij, Lusardi, and Alessie 2011; Behrman et al. 2012; Cooper and Zhu 2016).

Some individual are better at making financial decisions than others. Financial complexity has resulted in poor decision making. Some households have more financial assets than they used to, including retirement savings, insurance, living expenditures, debt, and other assistance for significant life eventualities. However, a large number of individual make terrible financial decisions. Some households may put all of their money into a residence where they live. Some of them had equity in the firm where they worked. Some households only have savings deposits with low interest rates, or they take out expensive loans and are frequently deeply indebted. Households must concentrate on individuals' or families' day-to-day money management as well as their capacity to prepare for long-term financial objectives. To achieve economic well-being, it is critical to have behaviour to overcome financial crises from family money management. It is also critical for the normal family attempting to manage their budget, purchase a home, support their children's education, and secure an income when the parents retire. Individual must be accountable for managing their own finances, such as going on vacation, investing in financial instruments, and making other financial decisions that will affect future financial decisions.

Households differ in their savings, lifetime wages, and cash motives, as well as in their time preferences, health, lifespan, inheritance, and other demands. Due to the inaccessibility of financial information at times, the relationship between wealth accumulation and financial capacity has gotten significantly less attention. There has been an increase in research on measuring financial literacy and its impact on household behaviour (Rooij, Lusardi, and Alessie 2007).

Over the years, personal financial planning has developed quickly and become a discipline that is relatively significant in the world of finance. In addition to discussing how individual should manage their finances, it also discusses how they should behave, which is thrown off by cognitive errors, which typically happen when individual lack full knowledge, have problems with their mental processes, have problems with their perceptions, or have distorted perceptions (Mahapatra et al.,2019). According to Palmer, Goetz, and Chatterjee (2009), the current unstable economic climate has made individual investors more dependent than ever on a financial planning culture. Saving money and building future assets are two aspects of sound financial planning. The Shefrin and Thaler (1988) behavioural life cycle hypothesis offers a theoretical context for asset creation and saving. Individual follow some self-imposed regulations, such as limiting their borrowing to specific types of purchases, paying off their credit card balances each month, or aiming to save a certain amount each month (Beverly, McBride, & Schreiner, 2003).

Personal finance planning has increased over time, according to Altfest, but many consumers still lack a high degree of financial knowledge. Many consumers, for example, may struggle to grasp the fundamentals of what a bond is and how interest rates effect its price. Individuals in this category are disproportionately poor and uneducated. By seeking advice

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from others with greater information, especially financial specialists with less personal experience, people might avoid making mistakes. Individuals must also understand if financial literacy influences financial behaviour in the qualities of high skills and ability, or patience, and the association with financial decision making (Andoko et al, 2020). At this time, when financial decisions are more complicated and important than ever before, there is a great unmet need for understanding. Barberis and Huang (2001) discovered that investors are loss averse and use restricted framing in their Mental Accounting while investing in firm-level stock returns. According to Grinblatt and Han (2005), individual frequently develop Mental Accounting formation when evaluating the performance of stocks in terms of revenues and risks because they take recent results and stock performance into account when investing and end up making mistakes with long-term investments. The applicability of Mental Accounting to the pricing of option contracts is examined by Rockenbach (2004). Hanna and Lindamood (2010) develop a theoretical model of the economic benefits of Personal Finance planning by merging three benefitting areas: increasing wealth, avoiding loss, and smoothing consumption. According to Chase, Gjertson, and Collins (2011), the majority of personal saving studies are more concerned with retirement savings than they are with emergency savings or short-term financial instability. According to Lusardi and Mitchell (2011), many American households do not have emergency funds.

Even though each person's psychological makeup plays a unique role in how they make financial decisions, within this framework, individual's capacity to process all the information is severely constrained. They employ a limited number of cognitive shortcuts, or "heuristics," to streamline their financial decision-making process in order to manage the quantity and complexity of information. In this study, we study that it is of importance to consider not only basic knowledge but also sound financial behaviour or the ability to apply that knowledge when investigating the determinants of household planning.

2. THEORY AND BACKGROUND

Hazel Kyrk conducted the earliest known study on personal finance in 1920. Margaret Reid, a Home Economics professor at the same university, is widely regarded as a pioneer in the study of consumer and household behaviour. A decision-maker might not always make the best financial choice due to limited educational resources and personal preferences, according to Nobel laureate Herbert A. Simon in 1947.

Lewis Altfest (2004) identified the origins of personal finance from the development required of personal finance as distinct dimensions. Personal finance has its origins in economics, finance, and behavioural science, as this field evolved from 'home economics' through different finance theories to behavioural finance. Essentially, no theory has been devised for the PFP, although portfolio theories are used as the foundation for investing at each personal finance stage or life cycle phase. According to Mason and Wilson (2000), Personal financial planning equips individuals with the information, aptitude, and skill set required to become inquiring and educated consumers of financial services and to effectively manage their money. Financial literacy refers to the ability to plan and make wise financial decisions using one's knowledge of money, credit, investments, banking, insurance, and taxes, as well as one's understanding of the basic principles of financial management (such as risk, loss, and gain). Thus, personal finance differs from economic and financial studies in that it aims to give total well-being to individuals and households. Personal financial goals include short-term objectives like saving for a down payment, long-term objectives like planning for retirement

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or long-term objectives like purchasing a property (Warschauer, 2001). In their study, David Block and Robert Sweeney (2004) identified the methods that a person utilized to reach financial well-being while making decisions about their personal or household finances. They described the six phases of financial planning as follows: recognize spending patterns, examine spending patterns, set objectives, get serious, seek for support, and continually assess.

Personal finance is a dynamic process that is impacted by a number of elements both inside and outside of the individual (Tahira Hira, 2009). These influences include financial markets and institutions, governmental organizations, economic, demographic, and social trends, as well as individual and family considerations. Numerous key demographic factors, such as age, education, wealth, marital status, and the number of dependents in the family, which are strongly related to life phases, have an impact on the personal financial planning process and each facet of this structural process (Moreschi, 2005).

Household finance is difficult to research because household behaviour is difficult to quantify. Yamana (2016) claims that the study of household finances has non-negligible effects on the literature on asset pricing as well as other fields, however conducting empirical research on this subject is difficult. On both the macroeconomic and microeconomic levels, household finance research is moving in a number of different directions. It includes the assessment of the economic and financial circumstances of individual portfolio decisions at the microeconomic level. When it comes to household finances, Campbell (2006) identifies two major obstacles to overcome: how to accurately evaluate household portfolio choice, and how to correctly model decision-making. Yamana (2016) expands on this list by including the problem of estimating structural parameters in the proposed theoretical model using information on household portfolio choice. The researchers' main area of interest in their work is determining the relationship between household activity on the financial market and the values of various assets, notably shares. Consumption-based asset pricing models (C-CAPM; Ludvigson, 2015) have been used to address these theoretical issues.

Men and women deal with financial information and concerns differently, according to several studies. According to a review of the research conducted by Barber and Odean in 1999, women and men approach financial decisions differently. Gender is the third most important factor influencing investment, after age and income, according to a survey commissioned by a major national brokerage business (Bajtelsmit and Bernasek, 1996). To determine the degree of financial literacy, Joanne (2011) gathered data from 748 households. They also examined investments in various financial assets using a life cycle framework. Since men often make financial decisions and have shorter life expectancies than wives, he gave priority to the need for financial literacy among women. Many professionals in the financial services sector have recently come to the conclusion that treating female investors as a distinct market niche with unique requirements necessitating new and distinctive marketing strategies is appropriate given the investment characteristics that are distinctive of female investors.

In a research published in 2010, Fisher sought to identify the variations in saving habits between men and women who are not married, cohabiting, or living alone. Income, age, risk tolerance level, preferences, and consumption demands were among the independent factors studied. According to the descriptive study, men and women have similar saving patterns, although women are less likely than men to save for the near term and are risk-averse. Using 3077 Netherlands families in 1988, Stefan et al. (1997) analyzed the portfolio allocation across 4 asset categories. They discovered that while age had a hump-shaped association, income,

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education, and tax all had favorable effects on the percentage of financial resources invested in hazardous assets.

Due to changes in the macroeconomic environment, research on changes in household financial behaviour has gained popularity in recent years. For instance, Kolasa & Liberda (2015) confirm the statistical correlations between Polish families' savings levels and other characteristics including income, family composition, and residence size. Taking into account changes in the economic climate, Utzig (2016) detects and assesses changes in the structure and value of family financial assets in Poland between 2003 and 2014. Hronová & Hindls (2013) re-count the reaction of households to the 2008 economic crisis in order to compare the behaviour of Czech households in the late 1990s to that of the period 2009–2012. The most important macroeconomic variables that affect the growth of family savings in Ukraine have been examined by Zhuk (2015). The economic health of a nation is always significantly influenced by the financial circumstances of individual households. Therefore, from a macroeconomic standpoint, it is necessary to look at the distinctiveness of the effects households have on the behaviour of financial markets as well as the entire financial system in individual nations. The rapid expansion of household credit during a recession and the early stages of a recovery period is partly a testament to the resilience of a financial system, but it is also a source of risk, as Côté (2011) also noted. Household finances have important implications for financial stability.

The majority of this study focuses on issues related to interactions between household behaviour, the state of the credit market, and the values of certain assets. This concentration can be attributed to the expansion of such research after the financial crisis of 2008, whose origins and consequences were directly related to consumer behaviour on the credit market. For instance, Stango & Zinman (2007) developed unique behavioural hypotheses on the connections between biased perceptions and portfolio selection, wealth levels, and the use and advantages of financial guidance. Stango & Zinman (2009) showed that more-biased families borrow more, save less, prefer shorter maturities, as well as use and profit more from financial advice, a set of behaviours dependent on a rich collection of household factors. This supported the notion they had previously proposed. Individual investors over extrapolate from their personal experience when choosing a savings strategy (Choi et al.,2009).

3. LITERATURE REVIEW

The studies show that financial literacy has a positive impact on the holding of risky assets by households (Chu et al. 2017; Clark, Lusardi, and Mitchell 2007; Guiso and Viviano 2014; Van Rooij, Lusardi, and Alessie 2011); this literature strand focuses on the relationship between financial literacy and household planning.

There is evidence that individual under save, make poor investments, and accumulate debt frequently (Mitchell, 2011; Reed & Cochrane, 2012). Financial decision-making is reported to be improved by increased financial literacy. In a recent study, Biener, Eling, and Schmit (2014) demonstrate how improving financial literacy strengthens the micro insurance market. Governments from all over the world have started to realise how important financial literacy is to having a successful life and have developed financial education programmes to help young individual learn it. According to Lusardi, Michaud, and Mitchell (2013), early career financial literacy training has a higher influence on financial outcomes since returns compound over a longer time frame. Jana (2016) examined the influence of investor attitude in

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the Indian stock market and the behavioural financial theory of irrationality in investing decisions among Indian investors.

According to Van Rooij, Lusardi, and Alessie (2011), individual investors in the Netherlands who are more financially literate are more willing to invest in equities. According to Clark, Lusardi, and Mitchell's research from 2017, the majority of investors who possess a sufficient level of financial literacy own more equities. Chu et al.'s (2017) analysis of data from the 2014 Chinese Survey of Consumer Finance shows that households with better financial literacy are more likely to own equities and mutual funds. According to several research (Gaudecker and Von 2015; Guiso and Paiella 2008; Hoffmann, Post, and Pennings 2013; Xia, Wang, and Li 2014), there is a positive correlation between financial expertise and owning risky assets as well as portfolio diversity.

Other studies (Behrman et al. 2012; Lusardi and Mitchell 2007, 2011) find favorable correlations between financial literacy and asset accumulation as well as financial planning, while further research is required to determine if these links reflect causality. For instance, Lusardi and Mitchell (2011) demonstrate that financial literacy increases the likelihood of encouraging good financial behaviour. By separating the causal effects of financial literacy on wealth creation using an instrumental variables method, Behrman et al. (2012) show that financial literacy is highly positively linked with wealth outcomes. Alhenawi and Elkhal (2013) found that there is just a tenuous connection between long-term financial planning and financial expertise. Improvements in financial literacy have a negligible impact on financial behaviour or planning, according to Fernandes, Lynch, and Netemeyer's (2014) research. The benefits are even more negligible in low-income populations. Because of this, people with good financial knowledge can make poor financial decisions, whereas households with lower incomes and less education are more likely to invest poorly (Alhenawi and Elkhal 2013; Campbell 2006), demonstrating that there are big gaps between what households know about finance and what they can actually do when making financial decisions. Unfortunately, the capacity for financial planning has not been explicitly associated with household planning in earlier studies.

Other than the literature on financial literacy and household characteristics, factors that affect household planning include wealth, income, age, education, and even social interaction (Campbell 2006; Cocco, Gomes, and Maenhout 2005; Cole, Paulson, and Shastry 2014; Cooper and Zhu 2016; Guiso, Jappelli, and Terlizzese 1996; Liang and Guo 2015). Household financial decisions are influenced by other demographic characteristics as ethnicity, gender, financial overconfidence, and marital status (Chu et al. 2017; Fan and Zhao 2009; Van Rooij, Lusardi, and Alessie 2011; Xia, Wang, and Li 2014).

3.1. Financial planning

Personal financial planning is a practical method for anticipating future household financial demands (Altfest, 2004). Personal financial management, on the other hand, is the science and art of handling funds on an individual basis, according to Murphy & Yetmar (2010). Personal financial management thus consists of two components: financial knowledge and managerial skill. Jia et al. (2021) define financial planning ability as the capacity of an individual to comprehend information relating to finances and to effectively apply that information to make sound financial decisions. Financial planning ability, in contrast to the idea of financial literacy, places emphasis on both knowledge and behavioural components.

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We propose a systematization of the definition based on two elements: (1) financial literacy, which is the capacity to comprehend financial knowledge such as financial concepts and products; and (2) financial behaviour, which is the practical application of financial knowledge in financial activities.

It is expected that a complicated, multidimensional model will be necessary to achieve the objective of defining complex financial planning behaviours. Personal financial planning comprises setting aside money to build wealth, protecting that wealth from loss of value and depreciation, carefully distributing that wealth over the course of the next life, and ultimately distributing the remaining fortune (Boon et al., 2011). When financial planning is done, the plan takes into account each person's unique circumstances. A person's capacity to manage financial demands including tax planning, credit and cash management, investments, insurance and risk management, and retirement planning is gradually developed and built through the financial planning process (Boon et al., 2011).

3.2. Household Behaviour

A household that is financially stable is better able to contribute to a vital community that is expanding quickly, resulting in community economic growth. According to Kenyon (1914), sound home financial planning is necessary to preserve stable household finances. The planning approach can help people gain control over their finances. Due to the unique circumstances of each person and family, financial planning is necessary to address specific demands and objectives (Sundjaja, 2010). Depending on their outlook on life, an individual or group of individuals may decide to determine this consumption pattern. This decision had a significant impact. Internal behavioural, life-attitude, motivational, and financial planning elements could create this impact (Oktavianti, 2017). Therefore, household behaviour will be influenced by financial planning. Financial behaviour, as defined by Nofsinger (2010), is the study of how people really behave in a financial situation. The resilience of a household's finances is highly correlated with its financial behaviour. Positive, focused, adaptable, organized, and proactive are the five primary traits of resilient people that may translate into behaviour in the financial industry. Consumption is impacted by historical variables and prior levels of consumption in addition to a person's income level at a certain period. The person will thus find it challenging to adjust his lifestyle and level of consumption to a lower standard if the income obtained is less than what is already received (Muammil, 2017).

3.3. Financial behaviour:

Financial knowledge and attitude, according to Potrich, Vieira, and Mendes-Da-Silva (2016), have a favorable impact on a person's financial behaviour. Additionally, they claimed that the degree of financial knowledge questions had a significant impact on monetary behaviour.

According to Schroders (2014), Financial behaviour influences attitudes toward risk and financial decision-making. Making sound financial decisions can be challenging since they are often impacted by irrational judgements, feelings, temptations, loss aversion, and procrastination (World Bank Report, 2015). When it comes to making decisions, emotions and the need for instant pleasure often winning (Andoko et al., 2020). Before making a choice, an individual must carefully consider all the costs and advantages, which may be described by findings from psychological research on how people make decisions (Shiller 2014).

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Financial behaviour, as defined by Nofsinger (2001), is the study of how people really act in a financial context. Financial resilience within households is directly correlated with household financial behaviour. Positive, focused, adaptable, disciplined, and proactive are the five primary traits of resilient people that might translate into behaviour in the financial industry (Danes, 2014). Kadoya and Khan (2016) assert that women exhibit better financial behaviour than males do. by means of their analysis in Malaysia. According to Ibrahim, Isa, and Ali (2012), preparing for retirement requires adopting sound financial practices. An individual's financial saving behaviour will be positively influenced by their level of knowledge or awareness of financial programs (Ntalianis and Wise, 2011).

4. FINDINGS AND IMPLICATION

There are several possible explanations for this positive impact. First, PFP can help households to better understand their financial situation and goals. This understanding can inform more informed financial decision-making. Second, PFP can help households to develop a roadmap for achieving their financial goals. This roadmap can provide motivation and guidance in the face of unexpected expenses or temptations. Third, PFP can help households to develop financial discipline. This discipline can help households to stick to their budget and save for their goals, even in the face of challenges.

The positive impact of PFP on HFB has important implications for policymakers and financial educators. Policymakers can promote PFP by providing tax breaks for financial planning services and by making financial planning resources more accessible to low-income and middle-income households. Financial educators can help households to develop financial knowledge and skills, and to create and implement financial plans.

5. DISCUSSION AND CONCLUSION

Nowadays, due to increased needs, the economy, the environment, and other factors, people are more concerned with their financial situations. Humans are affected by times of financial difficulty, especially in the present financial crisis. Complexities in home finances have an impact on children and teens (McCormick 2009). Financial hardship impacts families, communities, and not just individuals, as has been extensively addressed by the media. Adults face difficulties due to high rates of debt, declining salaries, little savings, and a financial services industry brimming with complex product options.

The financial sector has been expanding the range of goods it offers to the general public, including individuals, families, and consumers. Individuals have utilized greater consumer credit and mortgage borrowing throughout the financial crisis, taking into account the total amount borrowed. Alternative financial services are available to individuals, including credit cards, leasing, payday loans, and other forms of debt. In addition, individuals will consider the changes to the pension systems, which are now more and more in charge of workers' savings, investments, and asset accumulation. Unsafe personal borrowing has caused issues for homes. It could be a hardship that serves as a sign of troubled finances (Rio 2009). The likelihood of debt issues growing is correlated with the rise in young people's debt.

In addition to the financial hardship that might affect a household's financial condition, individuals are unable to execute basic economic calculations and are unfamiliar with basic financial terms (Lusardi 2009). They must understand the basics of risk diversification, the distinction between nominal and real values, and interest compounding. Lack of retirement

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planning, a lack of involvement in the stock market, and bad borrowing habits can all be linked to illiteracy. However, a number of actions must be made to encourage saving and financial stability. The efficacy of the financial education program may be increased in a number of other ways as well. A person's lifetime anticipated utility is their expected value for the total of all of their period utilities discounted to the present from their current age to their oldest achievable age. A person's ability to make sound financial decisions will be influenced by their level of financial literacy. In this study, additional information regarding financial literacy is required so that participants may make decisions that won't later affect their families. The findings of this study are consistent with those of Chen & Volpe (2002) and Kumar, Watung, Eunike, and Liunata (2017).

Maintaining a sound financial household requires careful financial planning. Good financial planning may help you avoid financial disaster, and gaining financial stability can help you deal with your money problems. In today's world, financial issues are prevalent. The issues may include difficulties paying the payments, accumulating credit card debt, or being compelled to take out a second mortgage. By organizing and preparing a budget and setting a spending plan to pay off debt and save money, financial troubles can be avoided. Create a list of all monthly revenue, make plans for spending and saving, set aside money for savings, construct a budget, and adhere to it religiously are some strategies to prepare a family budget.

Where households have more financial assets and debt servicing must be properly handled, expertise in finance is certainly helpful. The degree of financial literacy of the decision makers is directly correlated with the quality of financial decisions. Numerous potential factors may be used to determine how better knowledge affects behaviour. Financial behaviour will be significantly influenced by financial socialization. It describes the process through which a person learns attitudes and behaviours in addition to theoretical information. It does not usually address concerns of family history in parental education. They need to be taught financial literacy, starting with the youngsters. It is important for the household to know about interest, inflation, and diversification.

According to behavioural finance research, more and more households are handling their own retirement planning. Economic anxiety has grown as a result of the reality that many households do not make the best savings and investment decisions and the knowledge that these decisions may possibly result in unacceptably low standards of living (Hung, Parker, and Yoong 2009). Financial education is necessary in the area of making financial decisions due to the rising demand for the demands of future financial planning. The ability to separate necessities from wants when making financial decisions will grow with excellent financial behaviour (Pandin, 2021). This will help you avoid making decisions that can later affect you or your family.

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