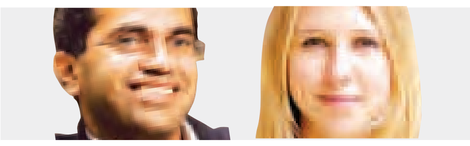
OPINION

FINANCIAL LITERACY

Financial literacy is not enough

Just as a stool is useless without any one of its three legs, financial well-being cannot be attained without knowledge, numeracy, and behavioral facilitation.



BY DILIP SOMAN AND NINA MAZAR

TORONTO—As we mark Financial Literacy Month, the fact that Canadians need to better manage their money and secure a strong financial future has never been truer than it is today.

Cataclysmic financial upheavals south of our border and the reality of our own growing consumer debts and savings rates that are significantly lower than a decade ago have made that need obvious to even the most casual observer. The December 2010 report of the Task Force on Financial Literacy noted that financial literacy is critical to the well-being of Canadians. Yet while it is important that we contend that financial literacy is not enough.

What is financial literacy? The task force broadly defined it as "the knowledge, skills, and confidence to make responsible financial decisions." This definition is a first step in the right direction. However, financial literacy programs have thus far focused primarily on disseminating knowledge while neglecting the need to develop numeracy skills and confidence. Numeracy goes beyond knowledge, as it requires people to have a mental model for dealing with non-intuitive mathematical relationships like compound interest, annual percentage rates, and fees. Numeracy can be aided by technology like online calculators, Smartphone apps, or even suitable rules-of-thumb. However, numeracy skills may not be the biggest problem that needs to be addressed today.

Years of researching decision-making behaviour have convinced us that many people are not good at converting intentions to actions. In domains ranging from saving to eating better, people consistently report good intentions that are not backed by action. Financial literacy will improve intentions, but it cannot improve our actions!

Financial well-being is a three-legged stool, with knowledge, numeracy, and behavioural facilitation as the three legs. Behavioural facilitation includes financial and social incentives, and a deep insight into human psychology to design environments in which people are nudged towards responsible choices. A good package needs to engage people by making the process fun and simple, and to educate them to make informed decisions. And it is in behaviour facilitation that we are lacking.

Consider the Canada Learning Bond. At its core, this is $500 of "free money" that the government provides to eligible families for their kids' education. Rationally, who would not participate? The answer in 2011 was 75 per cent. That is, only 25 per cent of eligible families participated. Perhaps some did not know about the bond, but our fieldwork shows that even among the ones who were aware, many were hesitant to open a bank account: they had no time, it was just one more thing to do, they couldn't make sense of the forms, there was a language barrier, or there was a comfort barrier. A simplified form or an easier account-opening process could have helped.

Or consider organ donations. Why are Canadian consent rates so low when Austria has a 99 per cent consent rate? It's because our default option is "not to donate" while in Austria it is assumed you will donate. There is an opt-out option in Austria, but the default simply encourages more people to donate.

Much has been said about the relative merits of behavioural facilitation versus financial literacy. The common refrain we hear is that literacy is empowering while behavioural facilitation is manipulative. This assertion would be true if people were perfectly rational and could reliably convert good intentions into action. Unfortunately, a vast body of research including our own shows us that they are not. Rather, the behavioural facilitation versus literacy debate is not the right question—the two need to work in tandem. But we contend that one critical bottleneck in getting people to accomplish anything is to get them act upon their intentions: help them open bank accounts, get tax free savings accounts, or sign up for RESPs. Behavioural facilitation could certainly help accomplish that.

Just as a stool is useless without any one of its three legs, financial well-being cannot be attained without knowledge, numeracy, and behavioral facilitation. Knowledge is crucial for long-term success, behavioural facilitation can help people get started, and numeracy will aid them in making better financial decisions. The social sciences have provided us with deep insights about what engages and motivates people to accomplish tough goals. Let us use all the tools and insights we have to build a prosperous and happy society.

Dilip Soman is the Corus Chair in communications strategy and a professor of marketing, and Nina Mazar is an assistant professor of marketing, at the Rotman School of Management. Join Dr. Soman for a Big Thinking lecture on Parliament Hill on Nov. 29 (www.ideas-idees.ca/bigthinking). This event is brought to you by the Federation for the Humanities and Social Sciences in collaboration with Credit Union Central of Canada (which recently released a publication that uses behavioural findings to evaluate financial literacy offerings) and the Financial Consumer Agency of Canada, and sponsored by TD Canada Trust.

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