



RESEARCH ARTICLE

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## DRIVERS OF FINANCIAL LITERACY AMONG HOUSEHOLDS OF WOLAITA ZONE, SOUTHERN ETHIOPIA

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### ABSTRACT

The main objective of the study was to assess the level of financial literacy and to identify economic and demographic factors that shape financial literacy finance in Wolaita Zone, Southern Ethiopia. A cross sectional data was collected from 217 households who are living in four districts (Humbo, Kindo Didaye, Damot Gale and Kindo Koyisha) of Wolaita zone in 2018. Ordinary least square (OLS) approach had used to identify the main determinants of financial literacy scores. The OLS estimation results revealed that education, ownership of cell phone, annual total income and age of the household head have positive effect on financial literacy. While, household living in rural area and long distance from bank/IMF have negatively and significantly affect financial literacy scores. The policy implication is that financial institutions and policy makers should give due attention for financial literacy program in order to bringing financially excluded people in to formal financial sector and in creating sustainable and efficient financial market. Financial literacy training to rural people is important to reduce the information asymmetry knowledge gap, to strengthen financial discipline and to enable them to make informed financial decisions.

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## INTRODUCTION

Ethiopia has giving the policy priority for pro poor approach in order to alleviate poverty, to reduce income inequality and improve welfare through creating opportunist and access to poor and marginalized groups. According to WTO (2016), financial institutions as "the brain of the economy", due to their multifunctional capacity to distribute and provide capital. An expanded access to catalytic financial tools can unlock development opportunities and can contribute in the process of improving the quality of life of all, especially the poor (UN, 2016). Banks, insurance companies and microfinance institutions are the major financial institutions operating in Ethiopia. Currently, the number of banks stood at 19 of which 16 are private and the remaining 3 are state-owned. During the year 2014/15 alone, banks opened 485 new branches (of which 359 were private) raising the total branch network in the country to reach 2693 from 2208 the previous year (NBE, 2015).

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As a result, bank branch to population ratio improved from 1: 39,833.84 people to 1: 33,448.25 in 2014/15. Presently there are 31 Micro Finance Institutions (MFIs) operating in the country. The ownership structure of MFIs is mixed- the big MFIs are partially owned by regional states and other small ones are owned by NGO 's and privates. The branches of MFIs have increased as high as 1385 to meet the demands for the financial services. In terms of client outreach ratio, it is one branch to 61,228 people (Getinet alemu, 2014). This reveals that still most of the population has no access to financial services. According to Cole *et al.* (2011) many of the people in developing countries excluded from financial market due to lack of financial knowledge about basic financial math and features of available financial products and that financial literacy is positively associated to the take up of key financial products in developing countries. Financial literacy is defined as the combination of consumers'/investors' understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being (Miller *et al.*, 2009).

Financial literacy		
<b>1. Knowledge and Skills</b> ➤ <b>Knowledge of financial concepts</b> Inflation & investment risk ➤ <b>Financial numeracy</b> Division and time Return	<b>2. Behavior</b> ➤ <b>Basic Money Management</b> Decision maker Household budget incidence Decision making - P2Y new ownership Sources of information - P2Y new ownership ➤ <b>Savings Behavior</b> Past 12 months savings method Savings sustaining power in the event of income loss Financial deficit – incidence / response ➤ <b>Financial Participation</b> Financial products awareness Current holdings Past 2 years purchase	<b>3. Attitude</b> ➤ <b>Attitude towards money</b> ➤ <b>Financial responsibility</b>

Source: OECD (2012)

According to Lusardi and Mitchell (2013) financial literacy is peoples' ability to process economic information and make informed decisions about financial planning, wealth accumulation, debt, and pensions which become increasingly important to enable individual and household to cope with the ever growing complexity of products and service in financial market. Financial literacy is one of the best ways to empower the working poor to take control over their financial lives and to achieve the goals of inclusive financial strategies. Financial literacy is very important to improve financial inclusion and ensure its sustainability (Cole *et al.*, 2011), because of the fact that lack of financial knowledge leads to poor financial choice and decisions, which could result in undesired financial and economic consequences to individual, financial system and entire economy.

The importance of improving personal financial literacy of population, thus, become important concern in policymaking, education and financial service industry both in developed and developing countries. The need for personal financial management has gained a surging popularity as financial markets become increasingly sophisticated and as households assume more of the responsibility and risk for financial decisions, financial education is increasingly necessary for individuals, not only to ensure their own financial well-being, but also to facilitate the smooth functioning of financial markets and the economy (OECD, 2005). Despite its importance, few have been known about financial literacy level and financial education programs in Ethiopia. The academic literature has given little attention to how financial literacy is measured. As far as my reading is concerned, there is no research on this topic in southern Ethiopia. The effectiveness of the programmes that target the improvement of financial literacy depends on knowing what factors influence people's financial knowledge. Thus, the main objective of the study is to assess the level of financial literacy and to identify economic and demographic factors that shape financial literacy in Wolaita zone, southern Ethiopia. The study hopefully is contributing to the development of financial literacy in Ethiopia within presenting compilation of theoretical underpinnings and empirical evidences, which will highlight potential research areas and policy issues.

## LITERATURE REVIEW

**Theoretical Literature Review:** Financial literacy as the ability to collect important information, and also differentiating between diverse financial option, discussing

financial issues, planning and proficiently answer that affect financial decision making (Paiella, 2016). Financial literacy is a conceptual model containing six basic components: (1) Saving Borrowings; (2) Personal Budgeting; (3) Economic Issues; (4) Financial Concepts; (5) Financial Services; (6) Investing (Titko *et al.*, 2015). Based on the OECD framework for measuring financial literacy in various country around the world, the framework consist of three majors variable; (1) knowledge and skills, (2) Behavior, (3) Attitude. Knowledge and skills measures the person's knowledge and skills of financial. Behavior measure the person' behavior about the basic money management, saving behavior and financial participation. Attitude measures the attitude towards money and financial responsibility. The framework of OECD as shown in the following table:

## Empirical review

The empirical evidences show that most people in developing country lack access to formal financial service. And this contributes to persistent poverty. Improving access to financial service, as part of the solution to poverty reduction in developing countries, has thus, become a global and national public policy concern (Gardeva and Rhyne, 2012). The financial knowledge poorer areas in developing countries are also covered in a study of Xu and Zia (2012). Aggrwala, et al. (2015) investigated that young working class show different financial knowledge, attitude and behaviour. They found that socio-demographic factors influence level of financial literacy. Anjali (2016) stated in a survey of Kamrup district in Assam that financial literacy level of an individual depends on one's financial needs and behavior. Potrich *et al.* (2016) assumed financial literacy as combination of three components i.e financial knowledge, financial attitude and financial behavior. It was found on analysis that financial attitude and financial knowledge influenced positively the financial behavior. Firli (2017) also traced in research financial literacy factors as knowledge, behavior, attitude and training for financial matters with socio-demographic factors as most influencing factors personal life experiences and life expectancy. Subha and Priya (2014) argued that as many developing countries have a large number of their population engaged in agriculture, such communities are especially vulnerable to income shocks which result from weather risk and price volatility in the goods they produce. As such, savings can be critical in allowing households to smooth consumption and support longer-term investments in human and physical capital. The ability to understand the degree of different investments can dramatically change the financial well-being of an individual.

Shankar *et al.* (2014) also indicated that, financially educated consumers encourage genuine competition by compelling service providers to innovate and improve efficiency, which is not only in the best interest of consumers, but also contributes to the development of financial system and sustainability of an economy. The outcomes of improved financial literacy would also help financial sector regulators. In this regard, Shankar *et al.* (2014) indicated that, financial literacy improves financial system regulatory mechanism, because of the fact that seeking and processing financial information by the common people reduces information asymmetry between financial service providers and client, which in turn, reduces market failure.

**Methodology of the Study:** To achieve this objective, quantitative approach has been employed. To analyzed the data, we applied both descriptive and econometrics analytical tools. The study relies predominantly on cross sectional primary data which collected through semi-structured questioners with face to face interview from selected sample households those live both in urban and in rural areas of Wolaita zone. A three-stage sampling techniques had used in order to obtain information from ultimate sampling unit (households). In the first stage, four *Woreda* were randomly selected to give equal chance for all *woredas* to include in the study. Next, a sample of 2 *Keble*'s (1 rural *Kebele* and 1 urban *Kebele*) were selected in similar methods from each sampled *woreda*. Sample household were selected by using random sampling technique from every sample *Kebeles*. In order to determine the sample size, the researchers used Cochran (1967) method since the population size is very large and unknown.  $n = \frac{Z^2pq}{e^2}$  Where; n = sample size P= sample proportion q= 1-P Z= Standardized normal variable and its value that corresponds to 90 % confidence interval equals 1.96; e = Allowable error 5% (0.05). Therefore, by using this formula and instating the figures, the sample size for this study was 264 households.

**Econometrics model:** It is obvious that the financial literacy score of individual is influenced by main demographic and economic factors, such as household income, educational background, access and sources of information, geographical location, gender, age and wealth status. Hence, in order to identify the variables which significantly affect the financial literacy scores of the households, multiple linear regression(OLS) model has been adopted. The model is formulated as follow:

$$FL_i = \beta_i X_i + \mu \text{ --- (1)}$$

Where FI is financial literacy score is computed the sum of three scores (knowledge score (54), attitude score (10) and behavior scores (5); thus, each respondent could attain a maximum financial literacy score of 69 and  $X_i$  is the socio-economic characteristics of the households.  $\mu$  is a random error term with mean zero and variance ( $\delta^2$ )

**Socio-Economic Characteristics of the sample respondents:** Table 4.1 illustrates the socio-economic characteristics of sample households. The survey included 16.13% female and 83.77% male respondents. The age distribution of sample respondents 17.512% of the respondents was age below-30, 47.00% of the respondents between the age rages 30-45, 45.62% sample respondents who age above 45. Regarding their level of education, majority of the respondents did not

attend any education. From the total sample respondents, 29.0% of respondents do not have any formal education, 14.28% have only completed primary education, 28.11% have attended secondary primary education (5-8 grades), 14.29 % have attended secondary education (9-12 grade) and remaining 14.29% of the respondents have attended college or university education. About 83.4% of the sample respondent was married while the remaining 16.6 % were unmarried (including single, separated/ divorced/ widowed). The geographical distribution of the sample respondents, 65% are living in rural, 18.43% living in semi-urban and remaining 16.59% of the respondents are living in urban. Geographical proximity of the bank or financial institution is an important factor for accessing and usage of financial services. The rural people are less likely to access formal financial services since getting the services may be consuming more time and costly. In the study area households are walking 41.64 minutes on average to reach nearest bank branch. This implies high transaction costs in using formal financial services. Access to correct and timely information with low cost will facilitate inclusive finance services. Cell phone, radio and television are the most effective ways to distribute such information to rural people. The important question is that how many households use these media instruments. As it has been shown in the table below, totally 47% percent of the respondents reported that at least one family member has cell phone, 16.6% households have TV and 35.02% households have Radio. With regards to income, on average, the households were earned up to 32405.31 birr per year and majority of the income generated from agriculture and agriculture related activities. The average loan was 905.4491 birr and the average saving was 2669.908 birr. This implies that the saving and loan distribution rate are very low in study area.

**Table 4.1. Socio-economic characteristics of sample respondents**

Variable	Frequency	Mean/%
Gender of head of household		
Female	35	16.13%
Male	182	83.79%
Age of the household head		
Average age of head of household	217	42.7037(11.49)
Age <=30	38	17.51%
Age between 30-45	102	47.00%
Age above 45	99	45.62%
Education status of the household head		
Illiterate /no education	63	29.03%
Primary education(1-4 grade)	31	14.29%
Secondary primary education(4-8 grade)	61	28.11%
Secondary education(9-12 grade)	31	14.29%
College or university education	31	14.29%
Residence of household rural		
Living in rural	141	64.99%
Living in Semi-urban	40	18.43%
Living in urban	36	.16.59%
Marital status of household head		
Married dummy	181	83.41%
Single/separated dummy	36	16.89%
Distance from bank/MFI	217	41.64(29.288)
Average loan	217	905.4491(2420.099)
Average saving	217	2669.908(5513.831)
Sources of income		
Nonagricultural income	217	6515.244(13505.6 )
Agricultural income	217	25890.07(48536.2 )
Aggregate income	217	32405.31(49926.18)
Ownership of information sources instruments		
Cell phone ownership dummy	217	47.00%
Television ownership dummy	217	16.59%
Radio ownership dummy	217	35.023%

Source: Author calculations from survey 2018, value under the brackets are standard error of the continuous variable

**Level of financial literacy:** The level of financial literacy is not constant among individuals. There are numerous factors which causes variation in the level of financial literacy within individuals. In order to assess how much is the gap within individual that is attributable to the different socio-economic composition, we compute the three financial literacy indicators such as financial knowledge, behavior and attitude. All the results illustrate in table 4.2 and in the next sub section we presented the correlation between socio-economic variables and each score.

**Financial Knowledge:** The financial knowledge is something that can measure levels of awareness and understanding of various financial terms and concepts of the households in the financial processes. The financial knowledge score is computed as number of correct response on the financial knowledge questions. The financial knowledge questions covered knowledge of diverse financial products and services (interest rate, loan, current account, saving account, microfinance, insurance, mobile banking, ATM, cash) and financial numeracy skill. Each of the knowledge evaluation question in the survey is assigned a score. When added together, an individual's total score indicates their level of personal financial knowledge. It is possible for the knowledge score to range from 0 to 54, with higher scores indicating higher personal financial knowledge and lower score indicate low personal knowledge. We have got that education is one of the main sources of financial knowledge variation among individuals. The result shows that the average financial knowledge score is high for those who attended college and university education in which the score is 30 and it is lower for those respondents those did not attend any education and for those attended primary education. From this, one can understand that rural people have lower financial knowledge as compare to semi-urban and urban people since they have less educational access. The average financial knowledge score for respondents those live in rural area was 21.897 where as it was 30.775 and 29.722 for respondents living in semi-urban and urban area, respectively. Because urban people has opportunities to know the financial products as compare to rural people. The knowledge score has not varied with gender and it comprises 24.901 for male and 23.571 for female. The levels of financial knowledge vary depending on the age of the respondents. The household head who is below 30 and age above 65 have low financial literacy score and the household head whose age is between 30-45 have large financial literacy score. This proves that financial skill and understanding increase with age for younger individuals and then decrease for older ones, with a peak at about age 65. From table 4.5 the results show that respondents with higher income tended to have higher financial knowledge score. While the average knowledge score for those with income level below average score was 22.774, those with an income above average income had an average financial knowledge score of 29.468. This may due to the reason that higher income groups have better chance to use financial products and to understand the financial concepts.

**Financial Attitude Score:** Financial literacy score variation is likely to be affected by the respondents' attitude towards various aspects of financial product usage and decisions. To identify the respondents' attitude, we have asked the respondents to answer ten questions that can evaluate their opinions. We assigned score 1 for correct response and zero otherwise. The attitude score is computed as the sum of the

value of ten statements. The attitude score is possible from 0-10. The average financial attitude score is 4.811. The attitude score is relatively high for female and it was 5.029 as compare to male whose score is 4.769. This implies that females have positive attitude towards saving, use of various financial products and spending their money properly than males do. Age is important sources of difference in financial attitude. The respondents those aged below 30 score is lower (1.814) while the respondents with age between 30-45 and above 45 score high 5.059 and 4.990, respectively. This prove that age have nonlinear relationship with financial attitude score.

**Financial Behavior Score:** The literatures shown that individual financial behavior have a significant effect on their financial wellbeing in particular and development of country's economy at large. In this particular study, we tried to capture evidence of behavior within the financial literacy measures. The respondents were asked variety of questions in different ways, to know their behavior regarding loan, saving money, financial planning, product choice and sending. The behavior score is computed as account of number of financial savvy behaviors. It ranges between 0 and 5. The average behavior score is 2.24 from the total score 5. This indicates that respondents experience to save money, recording, spending and income, use of credit and product choice is average.

**Over All Financial Literacy Score:** The financial literacy score is computed the sum of three scores (knowledge score (54), attitude score (10) and behavior scores (5); thus, each respondent could attain a maximum financial literacy score of 74. The result shows that the level of financial literacy is too low in the study area. The average financial literacy is 31.737 from the total score of 74. This implies that on average, one respondent could answer 32 financial literacy questions correctly. There are attributes that cause financial literacy gap among individual. Education is one of the important factors in ensuring adequate levels of understanding of financial concepts. The result shows that education creates difference among household financial literacy level. The average financial literacy score is high for those who attended college and university education (38). While the average literacy score is below overall average for those with lower education levels (illiterate and primary educations). There is no significant gap across gender since average level of financial literacy score is nearly equal for male and female. Moreover, financial literacy scores vary with age of the households' head. The household head with the age of below 30 and age above 65 have low financial literacy score and the household head whose age is between 30-45 have large financial literacy score. This proves that financials skill and understanding increase with age for younger individuals and then decrease for older ones, with a peak at about age 65. The scores are lower for those who are low income earners as compare to their counterpart. The literacy score is lower for those who live in rural areas as compare to those who live in urban and semi urban areas. So, the differences in socio-demographic composition play important role explaining the individuals' level of financials literacy score difference.

### Econometrics Estimation Result and Discussion

**Determinants of Financial Literacy:** In identifying factors which determine the financial literacy score, a set of demographic and economic variables were included in the regression model.

Table 4.2. Financial Literacy Scores

Demographics characteristics	Financial knowledge score	Financial attitude score	Financial behavior score	Financial literacy score
Over all sample	24.687	4.811	2.240	31.737
Living in rural	21.897	4.676	2.147	28.721
Living in semi-urban	30.775	6.025	2.650	39.450
Living urban	29.722	4.278	2.222	36.222
male hh head	24.901	4.769	2.253	31.923
Female hh head	23.571	5.029	2.171	30.771
Illiterate	23.984	4.429	1.730	30.143
Primary school (1-4 grade )	22.000	4.516	2.194	28.710
Primary secondary school (5-8 grade )	23.508	5.672	2.393	31.574
secondary school (9-12 grade)	25.839	3.968	2.258	32.065
College or university education	29.968	5.032	3.000	38.000
Age<30	13.642	1.814	1.618	14.426
Age between 30-45	26.314	5.059	2.588	33.961
Age above 45	22.768	4.990	1.838	29.596
income below mean	22.774	4.761	2.155	29.690
Income above mean income	29.468	4.935	2.452	36.855

Source: Author calculation based on own survey 2018

Table 4.6. Determinants of Financial Literacy Scores

Exogenous of variables	Coef.	Robust Std. Err.	t	P>t
Being male	-0.5820639	0.6140096	-0.95	0.344
Log of household head age	1.646423*	0.7244958	2.27	0.024
Log of household head age square	-0.2873855*	0.1248947	-2.3	0.022
Household head education level(years )	1.36369***	0.1177188	11.58	0.000
Distance from the banks	1.458013***	0.0192379	75.79	0.000
Living in semi-urban area	-1.092862	0.6478724	-1.69	0.093
Living in rural area	-2.122476*	0.6419329	-3.31	0.001
Being married	0.515285	0.6436491	0.8	0.424
Ownership of cell phone	1.601944*	0.5727454	2.8	0.006
Ownership of TV	0.1638802	0.7481523	0.22	0.827
Ownership of radio	0.1497607	0.4607848	0.33	0.746
Log of household wealth	0.0088193	0.0990333	0.09	0.929
Log of household income	0.0000178***	4.01E-06	4.42	0.000
_cons	4.983004	3.374366	1.48	0.141

Source: Author calculation

These variables were selected on the basis of theoretical explanation and previous empirical studies. Ordinary least square (OLS) regression methods has been used. Prior and post of running the regression, we conducted a conventional test included outlier test, multicollinearity and normality test. The heteroscedasticity test after OLS regression evidence that there is no a constant variance across individuals or it violate the homoscedastic assumptions. In order to avoid this problem, we used robust standard error regression approach. Table 4.6 illustrates the estimation result of the determinants of financial literacy scores. The estimation results indicate that age of the household head, household living in rural area, education, distance from individual residence to bank/IMF, ownership of cell phone and income have significant association with financial literacy scores.

**Age and age square of household head:** The estimation results indicate that age of the individual have no linear relationship with financial literacy scores. Log of age has a positive effect on financial literacy scores whereas log of age square has a negative significance effect on it. This means that an increase in the age of the individual increases the experiences with financial matters, knowledge and understanding on various financial services and financial numeracy skill. However, this will continue only up to a certain age limit since log of age squared had found to have negative correlation with financial literary scores. The result may have explained old age people in Ethiopia in particular in the study area has lower understanding and savvy about "new financial products" than young generation.

This is because the development of Ethiopia financial market has short history and concentrated in urban area so the older group may not know different new financial technical terms and complex financial products/services in the formal financial sectors.

**Education level:** was found to be significant and has positive effect on financial literacy scores. Since education is warranting adequate levels of understanding of financial concepts and products. An individual with higher education had higher financial literacy scores.

**Income:** is found to have positive significant effect on financial literacy scores. This implies that household with higher income had higher financial literacy scores. This is due to households' higher income may go to financial institutions to save money and it provide a chance to know financial concepts.

**Site location:** In order to examine financial literacy scores across different site, we include the geographical location of the households (rural, Urban and semi-urban) in our model and used urban as base variable. The result shows that rural dummy negative significant relationship with financial literacy scores. This means the households' live in rural area have lower understanding of financial concepts as compared to urban. It is obvious that rural people have less access to information, infrastructure and may have no financial intermediaries in their area all these limit their knowledge.

**Bank distance from individual residence:** it was measure the distance from bank/IMF branch to individual residence area in minutes. The estimation result evidence that bank distance has negative significant effect on the financial literacy scores. This means that households who are far from the bank/IMF branch score lower (could answer a few questions correctly).

**Ownership of cell phone:** in the modern world information is a powerful instrument to know and use different financial products and technology. To capture the effect of information on financial literacy scores, we used sources of information as proxy variables (such as ownership of television, radio and cell phone). Ownership of cell phone has significant positive effect on financial literacy scores. This implies that individuals who have cell phone, scores high as compare to their counterpart.

### Conclusion and policy implication

The study assesses the level of financial literacy and examined determinants of financial literacy in Wolaita zone, southern Ethiopia. The results show that the level of financial literacy is too low in the study area. The average financial literacy score was 31.737 from the total score of 74. This implies that on average, one respondent could answer 32 financial literacy questions correctly. The estimation results indicate that age of the household head, education, ownership of cell phone and income have positive and significant association with financial literacy scores. The higher level of education was generally found to be highly significantly and positively correlated with financial literacy. These results are consistent with the findings for study by OCED (2016), education is a significant factor in improving the financial knowledge, attitude and behavior of individuals and in fact it provides opportunities to understand basic financial services and made better negotiation with services providers. Income is found to be positive significant effect on financial literacy scores. Ownership of cell phone: in the modern world information is a powerful to know and use different financial products and technologies. To capture the effect of information on financial literacy scores, we used sources of information as proxy variables (such as ownership of television, radio and cell phone).

Ownership of cell phone has significant positive effect on financial literacy scores. This implies that individuals have cell phone scores high as compare to their counterpart. While, household living in rural area and distance from individual residence to bank/IMF have negative and significant correlation with financial literacy. In the rural area people have less access to information, infrastructure and may have no financial intermediaries in their area all these limit their financial literacy. Long distance from the bank has negative significant effect on the financial literacy scores. It is logical that households who live far from the town and walk long distance to reach on bank and MFIs branches, have low access of financial services and information. They are less exposed to modernization. Providing financial literacy to the rural people: The findings show that the financial literacy is low in the study area. It has significant effect on financial inclusion score. To reduce the information asymmetry and knowledge gap and to improved overall financial literacy, financial services providers, government agencies, universities and NGOs

should provide the financial literacy training to strengthen financial discipline and to enabled them to make informed financial decisions. Financial institutions should develop strategies to communication with rural people about their services. Besides, the universities should include financial literacy training in their education curriculum to improve financial literacy and financial wellbeing of people in the long run.

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