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Role of Financial Literacy on Risk Management in Financial Retirement Planning

Anu Eappen[1], Dr.Rekha Venugopal[2]
[1]Ph.D, Assistant Professor, Kristu Jyoti College of Management and Technology, Kerala, India.
[2]Research Supervisor, Lovely Professional University, Phagwarah, Jalandhar, India.
Emails: *eappenanu84@gmail.com[1], drrekha73@gmail.com[2]*

Abstract
In the framework of retirement planning, this conceptual study investigates the connection between risk management and financial literacy. Acquiring the knowledge and abilities required to make well-informed retirement planning decisions is largely dependent on financial literacy. It draws attention to the ways that financial literacy affects people's capacity to recognise, evaluate, and reduce retirement-related financial risks. This paper summarises the theoretical foundations of retirement planning, investigates the influence on risk perception and decision-making, and suggests strategies for improving risk management through financial literacy to enhance retirement outcomes by synthesising the body of available evidence.
Keywords: *Financial Literacy, Retirement Planning, Risk Management, Retirement Theories*

1. Introduction
Financial literacy, defined as the capacity to grasp and use financial knowledge, is a critical factor in successful retirement planning. This research investigates the role of financial literacy in promoting good risk management practices during retirement planning. Retirement planning is an important component of personal financial management, requiring individuals to make complex decisions about savings, investments, and spending. The increased unpredictability in economic conditions, shifting demographics, and the loss of traditional pension systems highlight the need for adequate risk management in retirement planning [1].

1.1 Research Objectives
- To understand the concept of financial literacy
- To study the role of financial literacy in risk management and retirement planning.
- To understand different retirement theories

Financial Literacy is the ability to understand and effectively apply various financial skills, including personal financial management, budgeting, and investing (Kenton, 2020). Financial literacy helps people become self-reliant, to achieve financial stability. As per OECD (2011), "a combination of awareness, knowledge, skill, attitude, and behaviour is necessary to make sound financial decisions and ultimately achieve individual financial well-being." Financial literacy also involves intimate knowledge of financial concepts like compound interest, financial planning, the mechanics of a credit card, advantageous savings methods, consumer rights, time value of money, etc (Agrawalla, 2012). Financial literacy is defined as "the ability to make informed judgments and to take effective decisions regarding the use and management of money" (Noctor, Stoney and Stradling, 1992, pg. no. 4). Being financially literate would mean that an individual would benefit from a palette of abilities and attitudes such as a comprehension of money management concepts, knowledge of the financial institution and attitude which enable effective and responsible management of financial affairs (Schagen and Lines, 1996). The growing body of literature relating to financial literacy suggests that consumers' comprehension of basic financial principles and products is minimal (Lusardi and Mitchell, 2011), (Atkinson and Messy, 2012), and might not be sufficient to guarantee sound financial decisions. The empirical evidence in different developed countries suggests that financially illiterate households are more prone to inefficient or low participation in the stock market, portfolio under-diversification, inertia in their portfolio management, over- indebtedness, and the

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use of informal sources of borrowing (Guiso and Jappelli, 2008; Kimballand Shumway, 2010; Klapper et al., 2013; Lusardi and Mitchell, 2007; Lusardi and Tufano, 2009) [2].

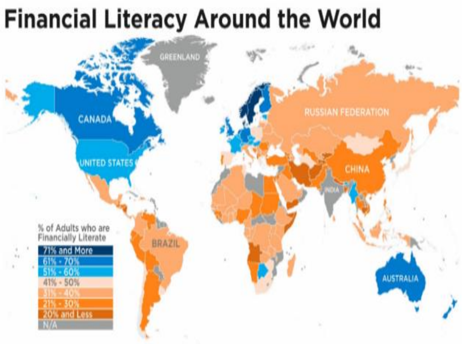

Figure 1 S&P Global Finlit Survey, Ullinois

The ten most financially literate nations are Denmark, Norway, and Sweden, each with 71% literacy, followed by Canada and Israel with 68%, the United Kingdom with 67%, Germany and the Netherlands with 66%, Australia with 64%, and Finland with 63%, according to a report on global literacy. Based to the survey, nations with developed and sophisticated economies, particularly those in Western Europe and English-speaking nations, it seems to have the highest levels of financial literacy globally.There is only one nation in Africa and none in South America where more than half of the population is financially literate. (Patrobas 2022) Retirement Financial Planning Rather than viewing retirement as the end of one's career, it should be understood as a succession of experiences (Beehr and Bennett, 2007). Financial stability, social connection and involvement, and health and wellbeing, according to studies (McNeil et al., 1983), are substantially related to an individual's retirement success. To maintain the same standard of living, people required to retire with at least 80% of their pre-retirement income (Smith, 1994). It is not merely a financial issue, but also a social and psychological one. The reason for this is that failing to maintain one's pre-retirement quality of living after retirement may be interpreted as a failure to fulfil familiar commitments. This leads to feelings of shame and ego deflation (McNeil et al., 1983). This scenario is exacerbated if the retiree is from a lower-income family and there is a significant discrepancy between pension and retirement benefits with salary drawn (Palmore, 1984). Draper et al., (1967) discovered that such concerns become more serious as the people get older. Increased longevity, inflationary pressures, the falling value of retiree assets, and concern about the future of social security, among other factors, ‘push' seniors to pursue a career after their required retirement (MetLife, 1996). When we turn the image, another tale emerges. There are many retirees who are financially secure yet desire to live an active and engaged life. Work here serves as a source of personal happiness, esteem, and respect as a non-monetary reward (Mor-Barak, 1995). Furthermore, it has been well proven that (Adans & Beehr, 1998) those who are content with their jobs are more likely to stay in the same or similar job rather than retiring completely. Because they have enough time and energy, Komp et al. (2010) discovered during their research that the willingness to continue working after retirement can vary from individual to organisational to socio-political. In general, males may prioritize attributes like as power, autonomy, skill and knowledge application, and financial incentives. Women, on the other hand, place a premium on social connections (Talaga/Beehr 1995). Personal financial planning entails a thorough examination of a person's current and future financial condition. It has existed in some form from the beginning of time. Personal 14 financial planning became more complicated over time as living standards rose and different complex financial instruments, fiscal policies, tax legislation, and so on were introduced. Although financial planning got more complex, it did not receive the attention it deserved from both academia and individuals (Altfest,2004) Nonetheless, personal finance has attracted attention in recent years from institutions, academia, political institutions, and consumers (Schuchardtet al., 2007). The results are shown in Figure 1. Furthermore, the movement of financial duties from collective to individual levels during postretirement years has emphasised the significance of timely financial planning. By 2050, 25% of the OECD population and 17% of the global population will be over 65 (Marchal et al., 2012), however only

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24.8% of people (globally) save for retirement (Demirguc-Kunt et al., 2016). Despite the gravity of the situation, many people approaching retirement are unprepared (Bruggen et al., 2017). interrupted work histories. All these variables reduce their earnings, resulting in fewer pension benefits. behaviour. The retirement planning model created by Hershey (2004) served as the foundation for the current study's research paradigm financial goals and a lack of understanding [3].

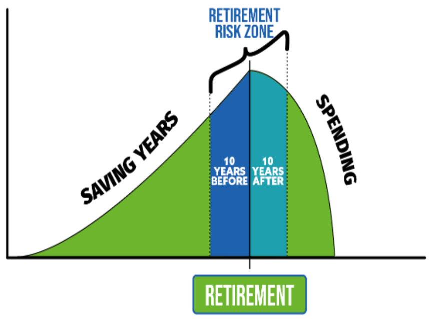

Figure 2 The Missing Phase of Retirement Plan- The Retirement Risk Zone

Figure 2 Risk management is a crucial step in retirement planning those entails locating, evaluating, and reducing possible risks to one's ability to maintain financial stability in retirement (Kuwalonda safari 2021) Longevity risk, inflation risk, market volatility, and medical expenses are important hazards. Proactive planning, income stream diversification, and retirement strategy modifications in response to evolving conditions are all necessary for effective risk management (True Tamplin 2023).

2. Strategies for Improving Risk Management

Diversification of Income Sources: Social Security, pensions, retirement savings, and annuities are just a few of the several income sources that retirees should take into mind. By diversifying, the risks connected to a single source of income are reduced. Managing an Investment Portfolio: Creating a diverse investment portfolio with a range of assets Asset classes (equities, bonds, and real estate) can act as a buffer against volatility and aid in managing market risk. Regular Review and Adjustment: Retirement plans ought to be evaluated and modified on a regular basis in response to modifications in individual situations or shifts in the market. Reevaluating one's risk tolerance as one ages is part of this. Emergency Funds and Insurance: To guard against unforeseen costs that can throw retirement plans, set up an emergency fund and think about purchasing long-term care insurance [4].

3. Theories of Retirement Planning

Life Cycle Finance Every individual goes through several stages of life, transitioning from one to the next. As a person grows up, goes to college, develops a job early, settles down, raises a child and takes on family obligations, makes retirement preparations, and eventually retires, time passes. Figure 3, We all have distinct needs and desires at every stage of life. Every stage has an own set of patterns for our income consumption and saving [5]. (Sivasankaran & Selvakrishnan, 2023; Modigliani, 1986)

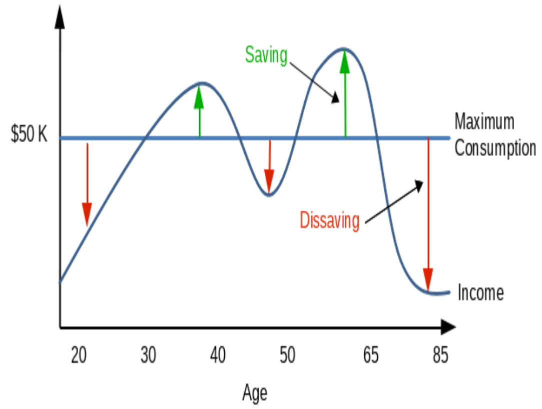

Figure 3 Life cycle finance-Bogleheads

Efficient Theories1952, Figure 4 Harry Markowitz presented the effective Frontier model. Investors can use this model as a guide to optimise their portfolios. It describes how to lower risk by selecting security that does not move together (Markovitz, 1952). Modern Portfolio theory Harry Markowitz developed this theory of portfolio selection, which is based on the Efficient Frontier theory. Figure 5, By optimising expected return at a specific level of risk, risk-averse investors can construct their portfolios, according to modern portfolio theory. Therefore, to diversify and spread-out risk, most people invest in a variety of asset classes. Both the Indifference Curves of Risk and Return and the Efficient Frontier are concluded by Modern Portfolio Theory [6].

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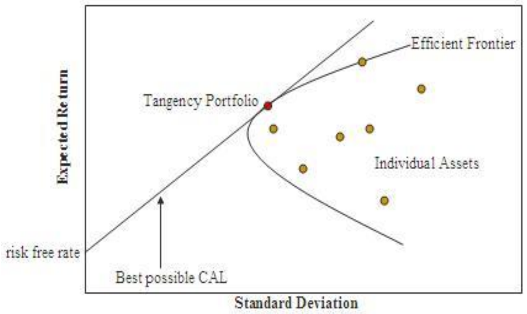

Figure 4 Efficient Frontier Model

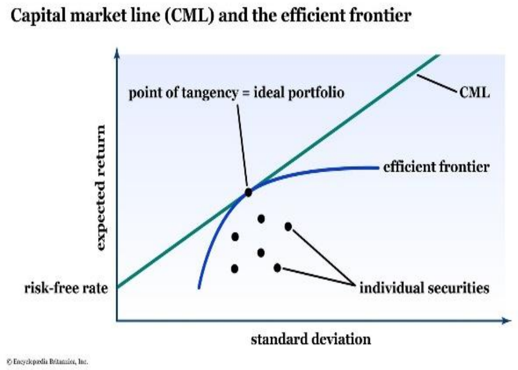

Figure 5 Capital Market Line and Efficient Theory

4. Discussion

(Jenning et al.) Residents' lack of financial literacy exacerbates the concerning consequences of high debt levels and inadequate retirement funds. A poor level of financial awareness is reflected by investors, suggesting that this is probably an underestimation for a fair assessment. Knowledge of different retirement theories enhances our comprehension of how people plan for their financial futures. The Life-Cycle Hypothesis and Permanent Income Hypothesis offer insightful information about saving habits. Collectively, these theories highlight the necessity for specialised financial education and guide optimal practices for retirement planning [7].

Conclusion

Successful retirement planning and efficient risk management are largely dependent on financial literacy. Policymakers and educators may enable people to make better financial decisions by improving their comprehension of financial concepts. By encouraging a financially literate public that can effectively manage risks and save for retirement, this empowerment not only helps individuals build personal wealth but also promotes economic stability.

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