

# Applying Theory to the Practice of Financial Education

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## Research

1. Angela C. Lyons, Urvi Neelakantan (2008) Potential and Pitfalls of Applying Theory to the Practice of Financial Education *Journal of Consumer Affairs* 42(1), 106-112.
2. Urvi Neelakantan (2008) Gender Differences in Risk Tolerance and Human Capital Risk.

# Question

- ▶ Three tasks of financial education
  - ▶ Define financial success
  - ▶ Change financial behavior
  - ▶ Evaluate financial success
- ▶ What is the contribution of theory to these tasks?
- ▶ What are challenges of using theory?

# Using Theory to Define Financial Success

- ▶ Theory can set a benchmark for optimal behavior (Campbell, 2006).
- ▶ However, goals for financial success are often set using rules of thumb instead.
- ▶ Two potential problems
  - ▶ Rules of thumb set the right goals, but for the “wrong” reasons.
  - ▶ Rules of thumb are inconsistent with what theory says is optimal (Canner et al., 1997).

# Using Theory to Define Financial Success

- ▶ Contributions

- ▶ Identify inappropriate goals.
- ▶ Suggest appropriate goals.
  - ▶ E.g., goals based on life-cycle theory (Deaton, 2005; Kotlikoff, 2006)

- ▶ Challenges

- ▶ Practical applications
  - ▶ ESPlanner (Kotlikoff, 2006)

# Using Theory to Change Financial Behavior

## ▶ Contributions

- ▶ Researchers are beginning to apply theories from other fields like the Transtheoretical Model (TTM) to financial education. (Lown, 2007; Shockey and Seiling, 2004; Xiao et al., 2004)
- ▶ Parallels are drawn between changes in financial behaviors and changes in health behavior.

## ▶ Challenges

- ▶ Setting appropriate benchmarks for positive financial behaviors.
- ▶ Taking exogenous factors (e.g., financial shocks, limited access to financial services) into account

# Summary

- ▶ Theory provides a context and baseline for
  - ▶ Defining financial success
  - ▶ Changing behavior
  - ▶ Evaluating financial success

## Previous Research

- ▶ Self-reported measures (Grable and Lytton, 1998; Sung and Hanna, 1996; Hanna et al., 2001)
- ▶ Risk-tolerance scores and instruments (Grable, 2000; Hallahan et al., 2004)
- ▶ Empirical observations of gender disparity in wealth accumulation and investment choices (Dwyer et al., 2002; Jianakoplos and Bernasek, 1998)
- ▶ Asset allocations within retirement plans (Bernasek and Shwiff, 2001; Hinz et al., 1997; Papke, 1988; Sundén and Surette, 1998)

# Outline

- ▶ Question
  - ▶ Does this result change if gender differences in human capital risk are taken into account?
- ▶ Methodology
  - ▶ Portfolio choice model with human capital risk
- ▶ Hypotheses
  - ▶ Women invest their financial portfolios more conservatively than men because their human capital is more risky.
  - ▶ Consequently, women end up with lower financial wealth at retirement.

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