

Authors

Gregory Fischer
London School of Economics and Political Science

Antoinette Schoar
Massachusetts Institute of Technology

Alejandro Drexler
Federal Reserve Bank of Chicago

Keeping it Simple: Financial Literacy and Rules of Thumb

By ALEJANDRO DREXLER, GREG FISCHER, AND ANTOINETTE SCHOAR*

Micro-entrepreneurs often lack the financial literacy required for the complex financial decisions they face. We conduct a randomized control trial with a bank in the Dominican Republic to compare the impact of two distinct programs: a standard accounting training versus a simplified, rule-of-thumb training that teaches basic financial heuristics. Only the latter produced significant improvements in firms' financial practices, objective reporting quality and revenues. Looking at treatment heterogeneity, the impact is especially pronounced for micro-entrepreneurs with lower skills or poor initial financial practices. These results suggest that reducing the complexity of training programs might improve their effectiveness, especially for less sophisticated clients.
JEL: C93, D12, I21, J24, O12
Keywords: financial literacy, entrepreneurship, business training, microfinance, adult education

1. Introduction

Individuals and micro-entrepreneurs alike are asked to make complex financial decisions in many areas of life, whether in their personal finances in the form of savings decisions and retirement planning or in a business context as small business owners or investors. However, a growing literature shows that a large fraction of the population is woefully underprepared to make these decisions. Lusardi and Mitchell (2007b) and Lusardi and Tufano (2009), for example, find low levels of financial literacy in the US population, an inability to understand basic financial concepts such as the importance of retirement savings, and poor judgment in borrowing decisions. Similarly, Cole, Sampson and Zia (2009) document very low levels of financial literacy for households in India and Indonesia. In addition, these studies find a strong association between understanding financial concepts, better financial decisions, and household well-being.

The challenge is to determine whether and how financial literacy can be taught and, closely related, whether there is a causal link between improving financial literacy and individual outcomes. The evidence so far has been mixed, with large heterogeneity in

* Drexler: UT Austin, alejandro.drexler@utsa.utexas.edu; Fischer: London School of Economics, Innovation for Poverty Action, and Innovations for Poverty Action Ltd., g.fischer@ecampus.lse.ac.uk; Schoar: MIT, NBER, and aschoar@mit.edu. We would like to thank Ximora Cabrita and Hilary Delgado for exceptional research assistance. We are also deeply indebted to numerous individuals at ADOREM whose dedication and patience were critical to this project. Particular thanks are due to Mercedes de Camello, Mercedes González de Buitrago-Gómez, Eva Carragón de Trullas, Eddy Sotomayor, Juan Francisco Torres, Charles Díaz, and Felipe Díaz. We are grateful to Vincent Hojman, Robby Gray, Doro Karlan, Sanchit Mukherjee, Russell Toth and seminar participants at the CPR Development Economics Workshop, Cornell, LSE, the Microfinance Impact and Innovation Conference, UT Austin, and the World Bank for many helpful comments and suggestions. Financial support from the IFC and two anonymous donors is acknowledged and gratefully appreciated.

Keeping it Simple: Financial Literacy and Rules of Thumb

Micro-entrepreneurs often lack the financial literacy required for the complex financial decisions they face. We conduct a randomized control trial with a bank in the Dominican Republic to compare the impact of two distinct programs: a standard accounting training versus a simplified, rule-of-thumb training that teaches basic financial heuristics. Only the latter produced significant improvements in firms' financial practices, objective reporting quality and revenues. Looking at treatment heterogeneity, the impact is specially pronounced for microentrepreneurs with lower skills or poor initial financial practices. These

results suggest that reducing the complexity of training programs might improve their effectiveness, especially for less sophisticated clients.

March 01, 2013