Chapter 12
The Impact of Financial Literacy on Financial Preparedness for Retirement in the Small and Medium Enterprises Sector in Uganda

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ABSTRACT

In social economic contexts characterized by young populations largely employed in the small and medium enterprise informal sector, retirement preparedness is an individual responsibility. This chapter explores the effects of age and financial literacy (knowledge, skills, attitudes, and behaviors) on retirement preparedness (RP). Primary data collected from a sample of n = 380 small and medium enterprise (SME) workers in Uganda is analyzed using SPSS. Measurement items are tested for validity and reliability to yield satisfactory composite reliability scores and average variance explained (AVE). Structural equation modelling (SEM) is used to test the hypotheses. The results reveal that specific behaviors, knowledge, and skills, but not attitudes, are significant predictors of RP. Also, that age does not significantly moderate the relationship between financial literacy and retirement preparedness. The chapter outlines practical implications for policymakers and financial educators in a developing country context.

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INTRODUCTION

Financial Preparedness for Retirement (FPR) encompasses an individual's ability to build the required assets to generate sufficient income to cater for their post-retirement financial life. A lack of FPR can have a negative effect on the individual's life, and that of their dependents and the entire society. Many countries such as the US, Italy and Germany, have implemented reforms in their pension systems to cater for their ageing populations (Prast and Soest, 2016). In many developed countries, employer-provided schemes have been replaced by "defined contribution" plans which are dependent on individual investment choices. Similarly, in developing economies, the capacity of government/public social security systems to cater to workers upon their retirement is highly inadequate (Topa, Lunceford, & Boyatzis, 2018). In the wake of these developments, policy makers world over are increasingly concerned with individual's capabilities to make retirement decisions that will benefit them through their lifetime. The shift of responsibility from public and employers, to the individual in highlights the importance of financial literacy. Therefore, a significant body of literature has been devoted to the relationship between financial literacy and financial preparedness for retirement.

Interestingly, FPR has moved from a purely economic concept to engender explanatory constructs grounded in psychology (Gallego et al. 2017) and finance (Topa et al., 2011), plus a host of other multidisciplinary integrated models (Wong & Earl, 2009; Wang & Shultz, 2010). Other studies such as Hershey, Lawson, and Austin, (2013) have proposed the capacity-willingness-opportunity model to explain FPR. The model includes the capacity dimension which addresses cognitive factors such as knowledge and skills, the willingness dimension which consists of the motivational drivers for planning and saving, and the opportunity dimension that addressed to the existence of external influences that affect retirement planning (Topa et al. 2018).

Contextually, 80% of the workforce in Uganda is employed in the small and medium enterprises (SME) private sector (UBOS, 2015). And yet the coverage of employer supported pension plan contributory schemes is mostly limited to the formal sector with a handful of informal retirement schemes (Ngabirano, n.d.). Further, the total working-age population (14 to 62 years) in Uganda is estimated at 19.1 million, with a total working population of 15.1 million, representing 79 percent of the working-age population (UNHS, 2017). Nonetheless, as of 2015, only 10.2% of the total Ugandan labor force was covered by a pension/retirement benefits scheme. According to the Uganda Benefits Retirements Authority, in 2015, the National Social Security Fund had 597,203 active members, the public service pension scheme had only 373,168 active civil servants and pensioners, the senior citizens' grant (SCG) had only 123,153 beneficiaries receiving only 25,000 Uganda shillings a month.

In contrast, other occupational schemes had only 24,174 subscribers (UBRA, 2015). This statistic implies that there is inadequate coverage with less than 1 million out of 15 million workers, benefiting from employer-sponsored retirement benefits scheme. Thus, over 14 million Ugandans must take individual initiative to plan for their retirement, otherwise they will be unable to meet their financial obligations during retirement and spend their retirement in poverty. The Uganda National Household Survey revealed that the levels of absolute poverty have increased from 6.7 million in 2012/13 to 10.1 million in 2016/17 coupled with a persistent decline in living standards and income distribution with no growth in consumption expenditure per adult between the two periods. Therefore, a lack of the requisite levels of financial literacy among individuals especially those working in the SME sector, could partially explain their financial unpreparedness for retirement and increasing numbers of people sliding into poverty upon retirement.

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