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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.
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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

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