Does Emergency Fund Provision Is Just About Saving? : A Conceptual Paper

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Abstract

Preparing for emergency fund becoming the one of the agenda that, encouraged by financial planners. The preparation of emergency fund could be found in line with the six major areas covers personal financial planning. Despite no specific definition for the emergency fund, previous studies have failed to address the main financial behaviours that contribute to emergency fund formation behaviour. This paper therefore proposed the conceptual model to address this issue.

Key words: Emergency Fund Concept, Financial Planning, Financial behavior

1. Introduction

Emergency events are related to an unexpected or uncertain crisis, such as sudden unemployment or illness (Johnson & Widdows, 1985) and might also occur from the unexpected increase in consumption current needs (Bi & Montalto, 2004). Preparing for emergency events by forming an emergency fund could be suggested to involve financial behaviour. Despite the fact that there is no specific definition for the emergency fund, most studies had tended to use definition proposed by Johnson & Widdows (1985)

Since preparing for an emergency fund is about financial preparation, it could be suggested that this relates to an individual's personal financial planning behaviour. This is because the reason for allocating the emergency fund, which had been discussed previously, is to prepare for future emergency events. Financial planners are found to encourage individuals to have an emergency fund (Anong & DeVaney, 2010; Hilgert, Hogarth & Beverly, 2003a). Consequently, the discussions in the existing literatures on emergency fund, such as the adequacy level, are mainly referring to the suggestion by the financial planner. In fact that there is no specific definition for the emergency fund, there has been no detailed investigation of the possible financial behavior involved in emergency fund allocation behaviour.

2. Literature Review

Personal financial planning is used to set an individual's personal financial plan. Personal financial planning is the specification of the approach and time target to achieve personal financial goals or financial needs. A personal financial plan should be flexible and allow access to individual current situations (Harrison, 2004) .

Most of the literatures (such as Chieffe & Rakes, 1999; Altfest, 2004) conclude that Personal financial planning covers six major areas. These can be summarised as:

1. Consumption-savings planning
2. Tax planning
3. Investment planning
4. Insurance planning
5. Retirement planning
6. Estate planning

Although the discussion brings us to the same meanings, the terms that are used are different. For instance, Altfest (2004) stated that risk management is considered the same as insurance management. Besides, liquidity management is considered as banking, money and credit management, and financing management covers personal loans and mortgages (Madura, 2006). Personal financial planning has been defined before as mainly about planning for future events. Emergency funds have also previously been described as planning specifically for future emergency events. In relation to this, it could be suggested that emergency fund in behavioural perspective is a part of financial planning. Saving, consumption and investment planning, which are the main areas in financial planning, are also found when looked at from an emergency fund perspective. This can be concluded from the way emergency fund categories represented in previous studies.

2.1 Emergency Fund Categories

The category of emergency fund was classified by Johnson and Widdows (1985) as being according to their degree of liquidity. The study categorised three major criteria, namely quick fund, intermediate fund and comprehensive fund. Other studies such as Huston & Chang (1997) and Bhargava & Lown (2006) further added other financial instruments which may suitable for their context of study. The categories of emergency fund were also were found to be different among some studies. Bi and Montalto (2004), for instance, used monetary fund instead of quick fund.

Further, after 2007, the trend in emergency fund studies, such as Rodriguez-Flores & DeVaney (2007) and Anong & DeVaney (2010), were changed to add another category of emergency fund: subjective fund. The subjective fund was measured using the question in SCF (Survey of Consumer Finances) 2007, which is, “about how much do you think you (and your family) need to have in savings for emergencies and other unexpected things that may come up?” A summary of previous studies on emergency fund criteria is presented in Table 1:

Table 1: Summary of Example Previous Research on Emergency Fund Classification

Previous Studies	Categories of Fund	Elements	Potential Financial Behaviour
Johnson and Widdows (1985)	Quick fund	Quick emergency fund, which consists of checking and savings accounts.	Saving behaviour
	Intermediate fund	Intermediate emergency fund, which consists of the value of certificates of deposit and savings certificates.	Saving behaviour
	Comprehensive fund	Comprehensive emergency fund, which includes the value of stocks and bonds.	Investment behaviour
Huston and Chang (1997)	Quick fund	Assets held in savings, checking and money market accounts.	Saving consumption behaviour
	Intermediate fund	Quick assets, plus CDs and savings certificates.	Saving and Investment behaviour
	Comprehensive fund	Intermediate assets, plus the value of stocks and bonds.	Investment behaviour
Bi and Montalto (2004)	Monetary assets	Monetary assets including assets held in checking, saving, brokerage accounts and money market funds.	Saving consumption and investment behaviour
	Comprehensive assets	Comprehensive assets include monetary assets plus investment assets held in certificates of deposit, mutual funds, stocks and bonds.	Investment behaviour
	Subjective fund	Subjective measure of emergency funds based on what respondents believed were an adequate amount of liquid assets for them to have available in case of emergencies.	Saving and investment behaviour
Bhargava and Lown (2006)	Quick fund	Quick emergency fund included checking, savings, and money market accounts.	Saving cosumption and investment behaviour
	Intermediate fund	Intermediate emergency funds included the quick measure plus certificates of deposit.	Saving and investment behaviour
	Comprehensive funds	Comprehensive fund included intermediate funds plus stocks, bonds, and mutual funds.	Saving and investment behaviour
Rodriguez-Flores and DeVaney (2007)	Quick fund	Quick emergency fund includes checking, savings and money market accounts.	Saving consumption and investment behaviour
	Comprehensive fund	Comprehensive emergency fund includes the value of stocks, bonds and mutual funds (but not retirement accounts) with the accounts that are considered as intermediate emergency fund.	Investment behaviour
	Subjective fund	Subjective measure of emergency fund based on what respondents believed were an adequate amount of liquid assets for them to have available in case of emergencies.	Saving and investment behaviour
Anong and DeVaney (2010)	Quick fund	Saving and checking accounts, money market accounts and call accounts.	Saving consumption and investment behaviour
	Comprehensive fund	Comprehensive fund includes intermediate fund (quick funds plus certificates of deposit) plus stocks, bonds and mutual funds that are not held in retirement accounts.	Saving and investment behaviour
	Subjective funds	Subjective measure of emergency funds based on what respondents believed were an adequate amount of liquid assets for them to have available in case of emergencies.	Saving and investment behaviour

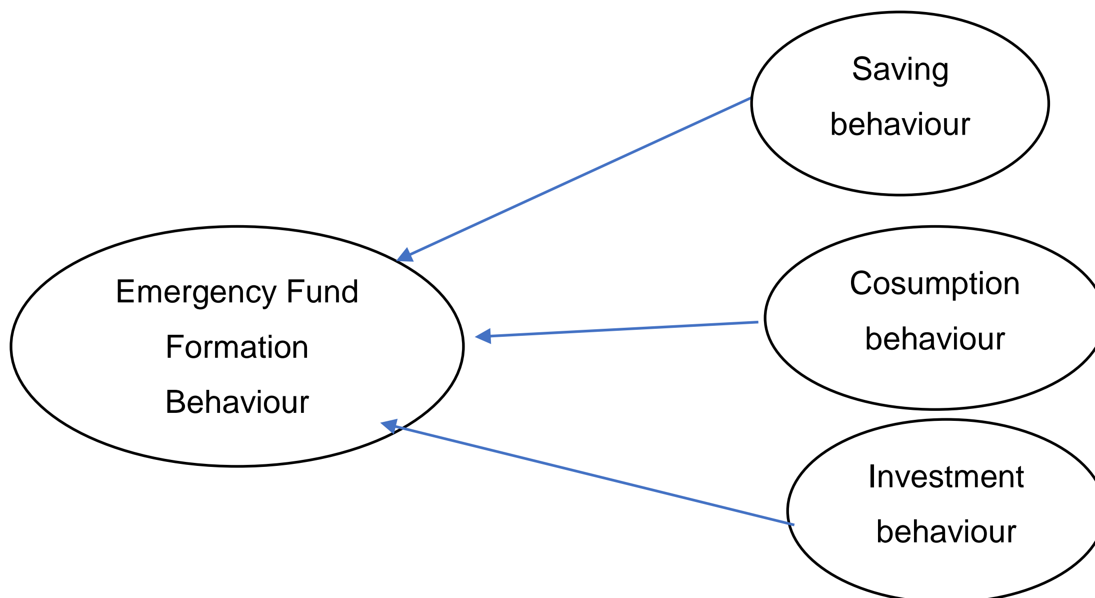
Sources: Johnson and Widdows (1985), Huston and Chang (1997), Bi and Montalto (2004), Bhargava and Lown (2006), Rodriguez-Flores and DeVaney (2007), Anong and DeVaney (2010).

A number of studies as referring to Table 1 shown that the trend of grouping emergency fund categories was changing from year. The changes also could be argued related to the potential financial behaviour that involved in emergency fund allocation behaviour. After all, it can be concluded that emergency fund provision behaviour, possibly included three main financial behaviour namely saving, cosumption and investment. For instance, the elements of savings account and deposit represents the saving behaviour. The money market instruments which are about short-term loans, represent consumption behaviour. Then, the financial instruments such as stock and bond, represent investment behaviour. As individuals might hold all of these instruments or either any instruments which already categories under those four emergency fund categories, namely Quick fund, comprehensive fund, intermediate fund and subjective fund, three financial behaviour could be argue related.

3. Research Framework

This conceptual paper proposed that emergency fund provision behavior could be suggest involve three main financial behavior namely saving, consumption and investment behavior as in Figure 1:

Figure 1: Emergency fund construct and items



To date, previous studies suggested that individual do save for emergency for instance those people in Japan put emergency savings as one of their highest priorities (Horioka & Watanabe, 1997). In China, the emergency saving motive was the main motive of savings, along with children education and retirement (Yao, Xiao & Liao, 2014). Studies by Bi and Montalto (2004), Bhargava and Lown (2006), Rodriguez-Flores and DeVaney (2007), Anong and DeVaney (2010), shown people do have emergency fund categories which already represented the investment and saving behaviour.

It was also found that individuals might have to borrow for emergency needs, but to have no cost of borrowing during the emergency could be beneficial (Hatcher, 2000). Therefore, by including some credit instruments into the same category of emergency fund, the behaviour of the emergency fund would be different. This is because Xiao et al. (2004) argued that the behaviour towards saving and credit are different. Bi and Montalto (2004) have argued that individuals who had access to credit via the retirement or pension benefit have less savings for emergencies because they know that they able to have an alternative when need comes. Besides, they further argued that the availability of home equity loan contributes to two difference findings. Individuals have fewer savings for emergencies when they have credit abilities. However, other individuals would also use the credit loan to increase their savings for emergency fund.

4. Conclusion

Therefore this paper attempt to provide insights definition of financial behaviour that involved in emergency fund formation behaviour. Previous studies lack item of definite the emergency fund which could be contribute to the scarcity of research on understanding the emergency fund as a whole, although, it has been argued that a complete understanding of the emergency fund issue could be achieved if it is studied from the behavioural perspective (Joo & Grable, 2006).More research is needed to better understand the connection of all the three financial behaviour. Further work needs to done to establish the proper model of emergency fund formation behaviour to understand emergency fund in the behaviour perspective.

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