CHAPTER 1
INTRODUCTION

1.0 Introduction

Financial management is that managerial activity which is concerned with the planning and controlling of individual or institutional financial resources. The concept ‘personal financial management’ is of immense interest to researchers, academicians and policy formulators in the context of economic crisis and financial inclusion. As in the case of a nation or business institution, finance plays a crucial role in the life of an individual too—either rich or poor. Mobilisation of finance and its wise and efficient deployment play a strategic role in the wellbeing of a nation or institution and at the most in the case of a person who is the base or starting point of any economic activity.

1.1 Finance Function

The term ‘finance function’ is more often referred in the context of business rather than individual. The definitions of the term fall into three broad categories. One group defines finance function as procuring or mobilising fund. Though this interpretation highlights mobilisation as the core of finance, it fails to explain the deployment or use of funds. The second category says that finance is related to cash and therefore, finance function is everything that takes place in the conduct of a business. Obviously such definition is too broad to be meaningful. The third approach envisages finance function as procurement of funds from most economical source and its effective utilisation in the business.
This approach is meaningful as it entails financial decision making after due consideration given to the various options for procurement and use of finance.

1.2 Personal Finance Function

When the third approach to business finance function discussed above is applied to an individual, it is personal finance function. Finance or money plays a pivotal place in the life of a person, either rich or poor. Money is essential for personal well being as well as well being of the family. Financial wellbeing dictates the quality of life.

Personal finance function covers the following essential elements:

1. Planning - planning mobilisation or procurement of money
2. Organising–having a cordial relationship between source and use of money with a specific goal.
3. Controlling- having some checks and balances in using money.

Personal finance is the application of the principles of finance function to the monetary decisions of an individual or family. It addresses the way in which individuals or households mobilize, spend and save money after seriously considering various factors involved in it. Components of personal finance include mobilising money, saving money in suitable avenues, spending for consumables and other assets, borrowing and investing or asset building.

1.5 The Concept of Financial Literacy

A number of definitions of financial literacy exist in the literature. Basically ‘financial literacy’ refers to the knowledge and understanding of financial concepts there by resulting in the ability to make informed, confident
and effective decisions regarding money. Financial literacy can be interpreted broadly or narrowly. In a broader perspective, financial literacy can be stated as “understanding of economics and how economic conditions and circumstances affect household decisions” (Worthington, 2006). A narrow definition of financial literacy focuses on “basic money management tools such as budgeting, saving, investing and insurance” (Natalie, Newton and Chrisann, 2010). It is the narrow view of financial literacy that is particularly relevant to individual decisions concerning financial matters.

1.4 Definitions of Financial Literacy

Different interpretations of financial literacy have been used in financial literacy studies resulting in no uniform definition. A number of studies have used financial literacy interchangeably with other names like financial capability, financial empowerment, debt literacy, financial knowledge, and economic literacy. Definitions used by major studies focus on knowledge and ability to make informed judgments to reach an intended outcome such as lifetime financial security and the skills required to realise those outcomes. Following are some definitions used by research scholars in selected studies.

i. “Financial literacy is the ability to make informed judgements and to take effective decisions regarding the use and management of money. Financial literacy is therefore a combination of a person’s skills, knowledge, attitudes and ultimately their behaviours in relation to money” (ANZ Bank, 2011).

ii. “Personal financial literacy is the ability to read, analyse, manage and communicate about the personal financial conditions that affect material
well being. It includes the ability to discern financial choices, discuss money and financial issues without (or despite) discomfort, plan for the future and respond competently to life events that affect everyday financial decisions, including events in the general economy” (Carol, A. 2000)⁴.

iii. “Financial literacy is a basic knowledge that people need in order to survive in a modern society” (Kim, 2001)⁵.

iv. “Financial knowledge is defined as understanding key financial terms and concepts needed to function daily in society” (Cathy, 2002)⁶.

v. “Consumer literacy is self-assessed financial knowledge or objective knowledge” (Marsha et. al, 2008)⁷.

vi. “Financial literacy refers to a person’s ability to understand and make use of financial concepts” (Lisa et al 2008)⁸.

vii. “Financial literacy is the ability to use knowledge and skills to manage financial resources effectively for lifetime financial security” (Mandell, L. 2008)⁹.

viii. “Financial literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being” (Sandra, 2010)¹⁰


x. “Mathematical ability and understanding of financial terms” (Worthington, 2006)¹².

xi “The ability of people to make informed judgments and take effective decisions in managing their finances” (MAS, 2005)¹³.
A thorough analysis reveals that all definitions convey the same meaning and attempt to define financial literacy as a state of understanding about finance. This understanding equips a person with the knowledge and skills needed to realise financial security of himself and his family and thus survive and achieve lifetime well-being. The definitions of financial literacy also refer to broad outcomes and explain that financial literacy provides lifetime financial security and well-being, the ability to respond competently to life events to survive in a modern society. The common thread of financial literacy is positive financial outcomes resulting from proficient competence in key financial activities and concepts.

1.5. Components of Financial Literacy

Financial literacy has three distinct but dependant components:

(i) Core competency

(ii) Proficiency, and

(iii) Opportunity

A financially literate person must be proficient in the core competencies, and be given the opportunity and environment to acquire financial literacy and its benefits.

1.5.1 Core Competencies

Based on review of literature, a financially literate person should be proficient in the following core competencies.

i. Numerical ability

ii. Budgeting, including the ability to keep track of expenses and income
iii. Saving

iv. Borrowing, and

v. Investment

The core competencies are applicable to all sections of the society irrespective of socio-economic or regional basis and can be expanded or refined, depending on the magnitude of spending, saving, borrowing and investing.

i. Numerical Ability

Numerical ability or basics of money relates to the knowledge required for the most essential day to day calculations involving finance. This takes the form of basic calculations connected with the cost of purchasing goods, paying bills, interest and discount calculations etc. At the basic level it is addition, multiplication, subtraction and division. Lack of numerical skills will certainly affect financial literacy. At higher level, it is the ability to understand financial statements or other accounting information, time value of money, risk analysis etc.

ii. Budgeting and Living Within Means

Budgeting means keeping track of finances and reducing unnecessary spending. Living within one’s own means is a skill necessary for effective budgeting, and budgeting is essential when there is limited income (MAS, 2005)\(^\text{14}\).

iii. Savings

Savings relate to setting aside some money for future use. It may be either short term savings or long term savings. While short term savings relate to
budgeting, long term savings are relevant to post retirement life or for purchase of costly items required in life such as a house or a car or even for marriage expenses of girl children.

iv. Borrowing

In modern era, borrowing is a way of life for all categories of people. Many people take up loans or mortgages. An indicator of competent borrowing is that loan amount should be relative to earnings. A large proportion of respondents in various financial literacy surveys did not understand the difference between an unsecured or secured personal loan, and fixed or variable interest rate. Debt literacy determines proficient borrowing. The core competency of a financially literate person is the ability to understand debt, and the processes involved to avoid it, reduce it and repay it. It also relates to competence in using loans (Lusardi and Tufano, 2009) and responses to debt including the ability to determine whether debt is justified (World Bank, 2008). Debt illiteracy is therefore related with over- indebtedness, and an inability to reduce existing levels of debt (Lusardi and Tufano, 2009).

v. Investing

Competence in investing and choosing the most suitable investment portfolio is another key feature of financial literacy. Selection of an investment portfolio depends on the finance available for investment and the purpose of investment. Investment may be in real assets or financial assets A Japanese survey suggests three criteria for choosing investments: safety, liquidity and profitability (Hiroshi, 2002).
1.5.2 Proficiency.

All the five core competencies described above are essential for financial literacy, but these competencies also require a degree of proficiency. Thus, a financially literate person must be proficient in the core competencies, having proficient financial knowledge, ability, skill and experience in the core competencies supported by positive attitudes about money.

i. Financial knowledge

An important aspect of proficiency is the level of financial knowledge of the people. This refers to a person’s level of knowledge of the core competencies and the conviction that financial knowledge will lead to financial wellbeing.

ii. Application of knowledge

Definitions of financial literacy in United States (PACFL, 2008)\textsuperscript{19}, Canada (Task Force on Financial Literacy, 2010)\textsuperscript{20}, United Kingdom (FSA, 2011)\textsuperscript{21}, and Australia (Financial Literacy Foundation, Australia, 2008)\textsuperscript{22} signify the importance of application of financial knowledge in financial literacy. The UK Treasury has stated that financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market (HM Treasury,2007)\textsuperscript{23}. However, knowledge cannot be usefully applied without relevant skills.

iii. Skill and confidence

A financially capable person possesses all the skills necessary to effectively manage finances to achieve well being, and this includes
communication skills, interpersonal skills, reading skills, mathematical and computational skills etc. The definition of financial literacy adopted in the United States by the Jump$tart coalition is “the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being” The element of confidence is added to the Canadian definition of financial literacy also together with skills. “Financial literacy means having the knowledge, skills and confidence to make responsible financial decisions” (Sandra Huston, 2010)\textsuperscript{24}. Remund in his search for a better definition to financial literacy states: “based upon a review of research studies since 2000, the many conceptual definitions of financial literacy fall into five categories: (1) knowledge of financial concepts, (2) ability to communicate about financial concepts, (3) aptitude in managing personal finances, (4) skill in making appropriate financial decisions and (5) confidence in planning effectively for future financial needs” (Remund, 2010)\textsuperscript{25}. Financial literacy therefore requires communication skills also. It includes the ability to apply knowledge and to communicate that knowledge, making financial literacy vital to effective decision making.

\textbf{iv. Attitude and Motivation}

Financial literacy is understood by the link from knowledge (Fox 2005)\textsuperscript{26}, to skills, to attitudes, to behaviour (Holzmann, 2010)\textsuperscript{27}. This link is important, because knowledge influences attitudes, which then manifests into particular types of behaviour (ANZ Bank, 2008)\textsuperscript{28}. Attitudes include whether people live
for today or for the future, or whether insurance is necessary or preferences for
risk etc (Financial Literacy Foundation, Australia, 2008)\textsuperscript{29}.

1.5.3 Opportunity to Acquire and Use Competency and Proficiency

It is important that a financially literate person should have the
opportunity to acquire skills, and use them. Participation in economic life should
maximise life chances and enable people to lead fulfilling lives and this
requires knowledge and competence, ability to apply that knowledge and
opportunity and environment to act (Elizabeth and Margaret, 2007)\textsuperscript{30}.

The component of opportunity stresses the social aspect of financial
literacy, which requires the equitable distribution of social resources that allows
people to participate in the financial markets. This can be referred to as the
financial inclusiveness of a particular society. Thus financial literacy promotes
financially and socially inclusive society which is the ultimate outcome of
financial literacy. A financially capable person is one who has the knowledge,
skills and confidence to be aware of financial opportunities, to know where to go
for help, to make informed choices, and to take effective action to improve his or
her financial well-being while an enabling environment for financial capability
building would promote the acquisition of that skills. An ‘enabling environment’
refers to an infrastructure, business model and regulatory system which
promotes and allows participation, excluding no particular groups or people
from the financial market.
1.6 Attributes Required for Financial Literacy

The research report by Capuano and Ramsay (2011)\textsuperscript{31} gives attributes required for financial literacy. The attributes are linked together to form a complete picture of financial literacy.

- Knowledge of financial information and core competencies
- which are understood;
- which can be communicated;
- that can be applied;
- with experience and skills;
- knowing where to go for independent and trustworthy help when necessary;
- with the ability to assess long term and short term goals, to make informed judgments and to plan and make decisions relating to finance;
- with confidence and motivation to take action;
- in a way that can be measured by knowing the core competencies of financial literacy;
- where a decision is considered in light of its context, such as economic conditions or forecasts;
- in an environment that allows the opportunity to acquire and exercise financial literacy skills;
- and the action results in positive outcomes;
- thereby increasing lifetime wellbeing.
1.7 Financial Literacy and Financial Wellbeing

Financial literacy and financial wellbeing are mutually related (UNDP and PFIP, 2010). Financial wellbeing is the ability to have our wealth serves our life - to have the financial means to comfortably attain whatever personal goals we have to enjoy a gratifying lifestyle. Sociological research data indicate that four factors strongly predict happiness and overall well-being in most cultures: health, economic status, employment, and family relationships. People are happier when they are healthy, employed, married or in a committed relationship, and financially secure.

There is a relationship between an individual’s ability to do something (capability), the demonstration of ability to do something (competence) and wellbeing (both self-perceived happiness and economic wellbeing). Wellbeing is, at least in part, a product of competent behaviour enacted consistently over time. Financial capability and financial competence therefore influence a person’s wellbeing. The opportunity accorded to people to engage with the formal financial system and how well they manage the money they have will influence their standard of living and the standard of living of those for whom they are responsible. Like never before, researchers, public authorities, community groups, industry associations and international organisations, are initiating financial literacy programmes and want to understand how people can become financially literate, or in other words, have the knowledge, understanding, skills and competence to deal with everyday financial matters and make the right choices for their needs.
1.8 Financial Literacy and Economically Marginalised People

Access to finance, especially by the poor and vulnerable groups is a prerequisite for employment, economic growth, poverty reduction and social cohesion. Further, access to finance will empower the vulnerable groups by giving them an opportunity to have a bank account, to save and invest, to insure their homes or to partake in credit, thereby facilitating them to break the chain of poverty. A well-developed financial system brings poor people into the mainstream of the economy and allows them to contribute more actively to their personal economic development.

People need the opportunity to participate fully in the life of their community if they are to flourish and realize their potential. But certain groups in the society suffer financial as well as social exclusion. Financial exclusion often causes poverty. Economic marginalisation is a process that relates to economic structure and in particular to the structure of the financial market and their integration. To the extent that from the financial market, some individuals or groups are segmented in general, these individuals or groups can be said to be economically marginalised from the rest of the economy. This segregation results in exclusion of the group from the financial market. The economic behavior of the marginalised group is distinctly different from the dominating group or elite group.

Marginalised people in India can be divided into two main categories; traditionally marginalised and those marginalised in the wake and as a result of capitalist transformation. Marginalised people are those sections of the society
who are economically and socially depressed and alienated from the main stream. According to Prahalad, C. K. (2010) these people constitute the ‘bottom of the pyramid’ and could be a source of much needed vitality and growth. They represent extreme variety- in their levels of literacy, rural urban mix, geographical mix, income levels, cultural and religious differences and every other conceivable basis of segmentation. These people have to mobilize, spend, save and invest money to escape from poverty. They are to be streamlined into the main flow of the nation which is one of the objectives of financial inclusion.

1.9 Relevance of the Study

The following reasons explain the relevance of the concept of financial literacy as a research study.

i. Economic depression

One reason for the relevance of financial literacy lies with the severity of the economic downturn in almost all nations in the last decade and the extent to which it touched the lives of people in all walks of life and at all levels of economic well-being. This economic crisis has captured virtually everyone’s attention. Because the negative impacts have been so widespread and indiscriminate in terms of who was affected, almost all countries have now taken more interest in financial literacy and capability and are more concerned in propagating the importance of financial education.
ii. Increased financial responsibilities

Individuals have been taking on, or have been assigned, more and more financial responsibility – for managing money and debt, saving for education, saving for retirement, and managing high-priced purchases, such as houses. As they take up more responsibilities and as the responsibilities become more complex and challenging, they should be equipped with more capabilities to encounter the challenges they will face.

iii. Financial challenges in life.

Financial challenges in every individual’s life are increasing day by day. People are living longer, living longer in retirement, and often facing the need to care for aging parents. As life challenges increase, there is mounting concern on the financial capability of a person as money is essential to meet all the demands either personal or relating to family.

iv. Causes of economic disparity

One of the causes of economic disparity is financial illiteracy. Economic disparity is increasing in many countries. It is the order of the day that the rich becomes rich or the poor becomes poorer or alternatively rich may become poor or poor may become rich. To the extent people know that variations in financial literacy and capability contribute to this growing disparity, the more interest they will show in financial literacy.


From Government’s point of view, there is the need to ensure the success and impact of financial policy initiatives. This can be assured only if the
policies and programs are better understood by those for whom they are targeted. Financial education and improved financial literacy and capability contribute to improved success of governmental programmes.

**vi. Aging population and social security measures**

Governments are, and will continue to be, financially stressed – especially with aging populations. The more people can achieve and maintain financial independence and self-sufficiency, the less they will be dependent on government support and assistance. To the extent that financial education can help improve the chances for an individual to achieve and maintain financial independence, the more benefits government can reap from reduced financial burden of social welfare programme.

**vii. Workplace productivity**

To the extent that financial education can help people better manage their financial affairs and live within their means, the less financial matters should contribute to stress, anxiety, ill-health, etc. This, in turn, should improve health, relationships, and workplace productivity. Financial literacy leads to employee productivity.

**viii. Information asymmetry**

Financial institutions, finance companies and professionals that offer and sell financial products and services currently have a significant advantage over those who buy them in that their knowledge and understanding of products significantly exceeds that of their clients. As such, there are considerable imbalances and inequities in the financial markets for products and services
between the buyers and sellers. Financial education should help to overcome some of these inequities in financial markets.

ix. Better debt management

One of the most significant problems encountered by many people relates to debt management. This draws considerable attention to the need for people to be better able manage their financial affairs and to help alleviate the potential for debt problems and living beyond one’s means.

x. Financial frauds

The proliferation of financial frauds and scams has also contributed to the increased interest in financial literacy. People should understand and avoid frauds and scams that may encounter in life.

xi. Inclusive growth

The concept of financial inclusion calls for the need for a financially literate people so as to take the best advantage of inclusion programme. Financial literacy and financial inclusion are two pillars of economic growth of the marginalised people.

1.10 Benefits of Financial Literacy

Financial literacy is important because it benefits people, the financial system and the economy in general. Financial literacy enables people to behave in a special way, and develop positive attitudes concerning money. The microeconomic benefits to the household extend out to produce macroeconomic benefits for the nation and the financial system.
1.10.1 Benefits to the Individuals

i. Increased savings

Financially literate people will have a greater capacity to save. This is achieved by financial efficiency which results in saving money and an enhanced ability to set realistic goals and select suitable investments to realise those goals. Many Studies have linked financial illiteracy with low levels of savings (Jappelli, 2010)\(^{34}\). A better-informed consumer will save for future and for unforeseen circumstances and emergencies (EFEP 2011)\(^{35}\).

An earning individual may face a sudden decline in income when he faces retirement or inability to earn income due to old age. Financial literacy is useful in life stages where important decisions are made, and as such financial education at these stages can successfully alter behaviour relating to retirement planning and saving (Oehler and Werner, 2008)\(^{36}\).

According to Kempson and Finney (2009)\(^{37}\), there are three types of savers: (1) rainy day savers who save regularly, (2) instrumental savers who save for a purpose and (3) non-savers, of which there are very few people. Their study proposes that with the correct education, non-savers can become instrumental savers, and instrumental savers can become rainy day savers. They further state that while some low income families want to save, and exhibit good saving behaviour, financial circumstances preclude them from acting in a manner consistent with their desires.
ii. More realistic assessment of financial knowledge

Frequently, there are news about cheating the public by money chain groups and other fraudulent companies and it is a pity that the literate people are more prone to these frauds. Many financial literacy surveys found that most people overestimate their financial knowledge (ANZ, 2008)\textsuperscript{38}, (Jump$tart, 2008)\textsuperscript{39} and (Kuzina, 2010)\textsuperscript{40}. Financial education ensures that people have a realistic view of their own financial knowledge and accordingly approach investments and financial decisions with due caution.

iii. Life skills and bargaining power

The best financial behaviour is achieved through the development of knowledge and skills, which provides the basis for making informed decisions. A skilful and knowledgeable person with positive attitude towards money will plan spending. A study by the European Commission (2007)\textsuperscript{41} has found that financial literacy gives consumers greater bargaining power through understanding finance and terms when he deals with financial service providers. As a result, consumers can gain better deals and demand more from service providers. In light of the fact that contact with financial institutions is necessary for a normally productive and enjoyable life, the ability to understand financial institutions and the products they offer is an important benefit of financial literacy.

iv. Financial efficiency

Rajat Nag, Managing Director General of the Asian Development Bank stated that (2007)\textsuperscript{42} “Financial literacy allows people to increase and better
manage their earnings and therefore better manage life events like education, illness, job loss, or retirement”. An Individual is confronted with many products and services in the market with varying offers and values with which he is often confused. Financial efficiency can include selecting the best value product on the market, and paying the lowest possible price on the market for a particular product or service. Financial efficiency is achieved by resorting comparison shopping, an important attribute of financially literate consumers. Comparison shopping leads to savings by purchasing the best value products at affordable prices.

v. Lifetime utility and financial wellbeing

Financial literacy should result in much more than realising financial goals. The optimal enjoyment of life at the lowest possible price is the result of financial literacy. That is, behaviour that result in unnecessary expenses, such as spending more than ones disposable income, choosing the wrong financier, paying higher interest rates, selection of wrong investment avenues etc. are the outcomes of financial illiteracy. The end result of financial literacy is lifetime financial well-being or realising financial goals and healthy household balance sheets. “Measures of financial wellbeing include increase in wealth, income, savings, manageable debt relative to assets, home ownership, accumulating retirement savings and an investment portfolio that reflects the needs of the individual” (Tatom J, 2010).
vi. Active debt management

Financial efficiency, also linked with ‘debt literacy’, includes financial knowledge of debt and how best to avoid and manage debt. Debt illiteracy can be linked to a number of high costs financial experiences, such as borrowing on high interest rates from local money lenders, using pawn shops etc. Prudent borrowing or careful borrowing takes into account cost of borrowing, thereby resulting in significant savings to consumers.

vii. Active participation in financial markets

Financially literate persons have been shown to possess more financial products and be productive investors. Limited financial market participation, or inertia (Shawn & Nilesh, 2008)\textsuperscript{44}, may be a consequence of low levels of financial literacy (Gallery 2010)\textsuperscript{45}. Van Rooij (2007)\textsuperscript{46} found that people with low levels of financial literacy are significantly less likely to hold shares and stocks. Financially illiterate people avoid financial products which are perceived to be difficult to understand (Jappelli, 2010)\textsuperscript{47}.

viii. Investing and choosing the right financial products with confidence

A financially literate consumer will be more confident when making decisions about finance, thereby increasing participation in the market. Financial literacy can influence the types of products selected, and the types of investments made. Financial education can contribute to financial stability by helping consumers to choose appropriate products and services, leading to lower default rates, for instance on loans and mortgages, and more diversified and therefore safer saving and investment (Holzmann, 2010)\textsuperscript{48}. An improved
understanding of financial products and services develops greater financial confidence in consumers, who select the most appropriate products and organise those products in the best possible way.

ix. Knowledge of regulatory framework

Education in consumer laws is a component of financial literacy. This knowledge gives people the tools and understanding to identify and avoid fraudulent schemes and reduce the severity of falling victim to such schemes. This translates into lower levels of regulatory intervention because consumers are better able to take care of themselves. A financially literate person knows where to go for help.

x. Prosperous, healthy and happy life

Financial literacy skills enable individuals to navigate the financial world, make informed decisions about their money and minimise their chances of being misled on financial matters. Having financial literacy skills is an essential basis for both avoiding and solving financial problems, which in turn are vital to living a prosperous, healthy and happy life. Financial problems are often the basis for divorce, suicides, mental illness and a variety of other unhappy experiences. In addition, financial hardship can increase isolation, emotional stress, depression and lower self esteem, which in turn can generate or exacerbate marital tensions that lead to divorce and even to suicide. Financial literacy is first and foremost about empowering and educating people so that they are knowledgeable about finance in a way that is relevant to their lives and enables them to use this knowledge to make informed decisions.
1.10.2 Benefits to the Financial System

i. Efficient and healthy financial market

Financially literate people can create a more competitive, innovative, safe, stable, accessible, disciplined and liquid financial system and markets and also greater competition, innovation and quality products in the financial market. Financially literate consumers are more financially efficient. Seeking and purchasing better, cheaper and more appropriate products and services can drive efficiencies in the financial industry. This leads to increased competition, better quality products and greater innovation and diversity in the market.

ii. Coverage of risk

Financially literate people have a greater awareness of risk, and therefore they fully insure their assets. It reduces the burden on the financial system from under coverage of risk and underinsured ventures, reducing costly individual and institutional insolvencies and bankruptcies.

iii. Self-funding for post retirement life and old age

The increased saving and financial planning resulting from increased financial literacy also has positive effects on the financial system and economy. It reduces the burden on the state to provide pensions and government funding for people experiencing financial hardship. Financially literate people are more willing to build wealth during their working lives to fund post retirement and old age life.
iv. Escape from the unfavorable lending policy of financial institutions

Financial institutions and banks usually lend freely during good economic conditions and tighten lending when the economic climate turns bad. This policy can have significant negative impact on a borrower who heavily depends on borrowed funds. “In a financially educated society, borrowers will be less likely to take on more debt just because credit is cheap and freely available. As a result, they will have a far better chance of riding out an economic downturn without defaulting on their debt repayments – which, in turn, will help minimise the bad debt experience of financial institutions and by doing so help bolster the stability of the financial system (Keith Hall 2008).”

1.10.3. Benefits to the Economy

Improved financial literacy brings large benefits for both the economy and the individual. Developing countries have especially low levels of financial literacy. In India, for example, more than half of labourers surveyed (Max New York Life, 2008) indicated that they store cash at home, while borrowing from moneylenders at high rates of interest. This pattern of behavior –high interest loans and no interest savings, with the resultant high risk of theft-or frittering away -of savings worsens the financial situation. Financial literacy and financial education can change this phenomenon.

1.10.4 Benefits to the Community

Financial literacy brings considerable benefits to the community. It enhances inclusion in the financial markets and increased awareness by the public regarding financial issues, thereby creating an informed community.
i. **Financial inclusion**

Financial literacy allows those sections of society especially the marginalised and poor who are otherwise excluded from the opportunity to use financial products and services. Knowledge of zero balance savings account facility may prompt a person to open an account with a bank whereas no knowledge of the existence of such a facility will result in exclusion of those people. Financial literacy provides the understanding required to access financial products and services which allows people to become financially active. Financial literacy therefore increases social inclusion, and gives people the knowledge to avoid highly priced, unconventional and riskier forms of financial products.

ii. **Awareness of financial policies**

Changes in policies and programmes are taking place in the financial sector frequently. Financially literate people are able to assess financial policies of the government and the actions of financial institutions and the impact of these changes on their financial status. This creates better informed citizens who are able to make sense of policy reform to the financial sector and critically evaluate such policies.

1.11 **Conclusion**

Financial literacy plays a pivotal role in today’s complex financial scenario. It is an essential component for the empowerment of all categories of people as it gives them an understanding of how to manage their finances in the real economy in order to avoid unnecessary hardships, excessive debt and
possible financial exclusion. Moreover, it enables people to improve their understanding of the financial opportunities that the formal financial market offers to them. Financial literacy is best understood in terms of core competencies, and proficiency in those core competencies. The core competencies are: (1) money basics, including numeracy; (2) budgeted spending, ie, living within means; (3) planning savings; (4) borrowing and debt literacy; and (5) investment by choosing and understanding financial products and services. Financial literacy starts with proficient knowledge in these five core competencies.

The ability to apply the core competencies is complimented by skills and experience in those competencies, which enhances the efficiency with which one is able to act on their knowledge. Thus financial literacy is best defined by the process of linking the core competencies with the proficiencies, and taking into account whether the financial environment is inclusive such that people have the opportunity to become proficient in the competencies with the ultimate goal of financial well being.
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