CHAPTER 4
THEORETICAL FRAMEWORK OF
FINANCIAL LITERACY

4.0 Introduction

Can the marginalised people efficiently manage their financial flows? Can they save? These are questions that have engaged the attention of people trying to empower them. In the past, the poor were always addressed from the supply side through schematic finance, now a stage has been reached where we need to understand the demand side, i.e. financial status of the poor in the context of financial inclusion. It is known that not only the well to do people, but also the poor have money management styles of their own. In a broader sense the subject which deals with the overall money management of the people is termed as financial literacy. The focus of any discussion on financial literacy is primarily on the individual, who usually has limited resources and skills to appreciate the complexities of financial dealings.

4.1 Concept of Financial Literacy

At the very outset, it is necessary to distinguish between the general and specific meaning of the term financial literacy. The term ‘financial literacy’ comprises the words ‘financial’ and ‘literacy’, both of which are used to represent a myriad of issues that can easily lose their relevance when used together. According to Collins Dictionary and Thesaurus¹, the word ‘finance’ relates to the words ‘economic’, ‘business’, ‘commercial’, ‘monetary’, ‘fiscal’ and ‘pecuniary’, each of which has its own meaning. ‘Literacy’, according to the
same dictionary, basically means or is synonymous with the ability to read and write; education, learning and knowledge. When these words are combined to form the single term, ‘financial literacy’, a whole new dimension emerges, which encompasses more than the individual terms listed.

Widdowson and Hailwood\(^2\) (2007) in their Article ‘Financial literacy and its role in promoting a sound financial system’, state that “for some, financial literacy is a wide-ranging concept, incorporating an understanding of economics and how household decisions are affected by economic conditions and circumstances while for others, it means focusing quite narrowly on basic money management skills – budgets, savings, investment, insurance”.

But what does financial literacy mean to the marginalised people who are at the bottom of the economic pyramid in developing countries. Is financial literacy a relevant concern to them? This study is an attempt to prove theoretically and empirically that financial literacy is much more relevant in the case of marginalised people and can be improved through financial education. Financial literacy is a broad concept that includes both financial information and financial behaviour and it is relevant for all people regardless of their wealth or income.

Literacy is being defined as the condition or quality of being literate, especially the ability to read or write. Literacy is an indicator of general well being of a person or a country. High literacy is a symptom of better quality of life as well as development. Financial literacy is different from general literacy. The terms 'illiterate' and ‘illiteracy’ are commonly used by academics, activists
and lay people alike, and are not used to stigmatise individuals but to encapsulate the fact that they cannot read or more specifically write in any language. It is not universally believed that 'illiterates' lack good oral communication skills, mental arithmetic, general knowledge or the ability to think and participate in community and political activities. So, to label someone as 'illiterate' is basically a statement of fact, i.e. she/he cannot write.

Concern about financial literacy has increased in recent years, and many countries have embarked on programmes and other research initiatives to introduce and enhance financial literacy among their people. According to Braunstein and Welch\(^3\) (2002) financial literacy, or the lack thereof, has gained the attention of a wide range of banking corporations, government agencies, educational institutions, consumer and community interest groups, and other organisations. In USA, studies on financial literacy were conducted, among others, by Cutler\(^4\) (1997), Chen and Volpe\(^5\) (1998), and the National Council on Economic Education\(^6\) (NCEE 2004). In the UK, financial literacy surveys were conducted, among others, by Schagen and Lines\(^7\) (1996) and the Financial Services Authority\(^8\) (FSA 2006). While these studies mostly investigated financial literacy levels among the general public and university students, a study by Joo and Garman\(^9\) (1999) focused on the relationship between personal financial wellness and worker job productivity. According to a study on the financial literacy of US working adults, Volpe, Chen and Liu\(^10\) (2006), found that working adults are not knowledgeable about personal finance topics.
The consistent themes running through various definitions of financial literacy include:-

(1) being knowledgeable, educated, and informed on the issues of managing money and assets, banking, investments, credit, insurance, and taxes,

(2) understanding the basic concepts underlying the management of money and assets; and

(3) using the knowledge and understanding to plan, implement, and evaluate financial decisions.

4.1.1. Salient Features of Financial Literacy

i. Financial knowledge

Financial literacy is concerned with financial knowledge. To some authors, it is a specific form of knowledge (Hilgert, Hogarth and Beverley 2003) regarding financial products and services.

ii. Application of knowledge

Financial literacy involves use of the financial knowledge which has acquired. Financial literacy is acquired through practical experience and active integration of knowledge. Knowledge influences behaviour or action.

iii. Personal ability

Financial literacy is purely a personal quality. It is the ability to evaluate and make judgments on financial matters affecting day to day life of a person.

iv. A determinant of household well being.

Empirical studies prove that there is a strong association between financial literacy and household wellbeing.
v. Managing money

People cannot live without money. Hard earned money should effectively be utilized. Financially literate person knows well about managing his money so as to make life smooth.

vi. Attitude

Attitude of a person about money has an important impact on his/her financial literacy. Attitude towards money, lifestyle, social status, formal financial education etc influences personal financial literacy and thereby future prospects.

vii. Measurement

Measurement of financial literacy is not simple as that of measuring general literacy. The methods of measurement varies according to the socio-economic background of the people whose financial literacy is studied, i.e., rich or poor either urban or rural.

viii. Universality

Financial literacy concepts are applicable to all sections of the society, rich or poor either in developed or developing or underdeveloped nations

4.1.2. Related Concepts of Financial Literacy

Many concepts share features with financial literacy.

i. Numeracy - Numeracy is basic number skills, which share features with financial literacy. In all strategies for measuring financial literacy numerical skill is a major factor. However numeracy applies much more broadly than to financial matters. It is closely aligned to cognitive abilities.
ii. Financial Education - Financial Education is a broader concept than financial literacy. Financial education is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial wellbeing. Financial education is a deliberate attempt through which financial knowledge and skills are gained rather than knowledge and skills themselves. Financial education is imparted formally by education providers initiated by Central and State Governments, Commercial Banks, Non Banking financial institutions, Non Governmental Organisations, Self Help Groups etc. Financial education is a concept that promotes financial literacy. Financial literacy should be the end product of financial education. Though some terminological differences are there many scholars use both financial literacy and financial education interchangeably on the proposition that a financially educated person definitely will be a financially literate person.

The term ‘financial education’ is commonly used instead of financial literacy. Intuitively, based on the usage of the terms education and literacy, one would assume that financial education leads to literacy. The OECD’s 2005 study has five chapter headings that use the term financial education, including the chapter dealing with definitions. The OECD’s definition includes elements of information, instruction, and advice and is very broad so as to be as inclusive and comprehensive as possible.

Financial education is the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and
confident to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.

iii. Financial attitude - Financial literacy should be distinguished from financial attitude. Financial attitude measures certain behaviours that are preference based. But financial literacy measures financial knowledge, skills in managing money. Attitude of a person towards money will have an impact on his/her overall financial literacy.

iv. Money - Money is generally accepted as a medium of exchange. Money is absolutely necessary for living. An individual earns money through wages, salary, honorarium, pension, profession, business, self employment, donation, etc. Financial literacy deals with handling one's money effectively for individual and household well being.

v. Financial management - Finance means the science or study of management of funds. In this sense, financial literacy and financial management are relating concepts. Financial management involves mobilisation of money, saving skill, spending skill and investment skill. Principles of financial management are same and are applicable to both individuals and institutions. Financial management skills of an individual can be referred as personal financial literacy.

vi. Economic literacy - Basically, economic literacy is that type of knowledge which is necessary to master a certain set of tasks related to economic matters. On a broader scale, economic literacy is viewed to comprise basic ideas in economics that every literate person should know (Dieter & Ralf 2005).
Economic education results in better citizens, capable of making reasonable judgments on public policy issues that have a bearing on their personal prospects and those of the nation. Economic literacy is concerned with understanding concepts such as productivity and inflation. By comparison, financial literacy is concerned with more personal or immediate matters such as saving, spending, banking, borrowing, and investing.

vii. Behavioural finance - Behavioural finance is the study of influence of psychology on the behaviour of financial practitioners and the subsequent effect on financial markets (Martin Sewell, 2007). Behavioural finance, also called Behavioural Economics broadly studies the effect of social, cognitive and emotional factors on the economic decisions of individuals and institutions and the consequences on market prices, returns and the resource allocation.

viii. Financial capability - Financial capability is understood as being a set of financial knowledge, skill, and behaviour among individuals. Financial knowledge and understanding is the ability to make sense of and manipulate money in its different forms, uses, and functions, including the ability to deal with everyday financial matters and make the right choices for one’s own needs. Financial skills and competence is the ability to apply knowledge and understanding across a range of contexts including both predictable and unexpected situations and also including the ability to manage and resolve any financial problems or opportunities. Financial responsibility is the ability to appreciate the wider impact of financial decisions on personal circumstances, the family, and the broader community, and to understand rights, responsibilities,
and sources of advice or guidance. A financially capable individual is one who has the 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 financial well-being. An enabling environment for financial capability building would promote the acquisition of those skills.

4.1.3. Objectives of Financial Literacy

Financial literacy enables people to have knowledge of concepts of money and how to manage it wisely. The aim is to facilitate people to become more informed financial decision makers, develop awareness of personal financial issues and choices, and learn basic skills related to earning, spending, budgeting, saving, borrowing, and investing money.

i. Financial literacy can help people set financial goals and optimize their financial options. In the context of developing countries, financial literacy is particularly relevant for people who are resource poor and who operate at the margin and are vulnerable to persistent downward financial pressures.

ii. Marginalised women, in particular, often assume responsibility for household cash management under difficult and unstable circumstances and with few resources to fall back on. They often lack the skills or knowledge to make well informed financial decisions. Financial literacy can increase their decision making power and prepare them to cope with the financial demands of daily life. It can help them prepare ahead of time for life cycle needs and deal with unexpected emergencies without assuming unnecessary debt.
iii. Financial planning can help people to take advantage of new financial opportunities. For microfinance clients, financial literacy can help them choose wisely among a growing number of financial options and use microfinance services to their best advantage.

iv. With better knowledge of the range of financial services available, their costs, and the risks associated with their use, clients can decide which ones best meet their needs.

v. Improved financial management skills and behaviour can help reduce the risks of running a business and financing business activities with loans.

vi. For microfinance institutions, improved ability of clients to manage debt can help keep repayment rates up and delinquency rates down. Involvement of Micro Finance Institutions in assessing financial education needs of clients can help staff understand financial management strategies of the poor, financial service gaps and how microfinance products and services could be improved and expanded.

vii. Financial literacy can play a special role for young people in developing countries by helping them prepare for productive and secure future. Adolescence is a critical time for learning basic skills related to earning, spending, saving, and investing money. However, most adolescents and adults learn these skills through trial and error. While money management is an important dimension of day-to-day life for everyone, money management skills can help young people to become more independent, self-confident, and be prepared for the future.
viii. Knowledge and practice of good money management can reduce the vulnerability of young people to many risks associated with adolescence. Financial knowledge can open up new opportunities to work, to build assets, and to expand horizons. Financial literacy is an important building block for adolescents and young people in developing countries because they often start to work at a younger age out of economic necessity. In poor households, adolescents often take on financial responsibilities at a younger age.

4.1.4. Importance of Financial Literacy

i. Financial literacy has assumed greater importance in the recent years, as financial markets have become increasingly complex and as there is information asymmetry between markets and the common person, leading to the latter finding it increasingly difficult to make informed choices.

ii. Financial literacy is considered an important adjunct for promoting financial inclusion and ultimately, financial stability. Both developed and developing countries, therefore, are focusing on programmes for financial literacy. In India, the need for financial literacy is even greater considering the low levels of general literacy and the large section of the population, which still remains out of the formal financial system.

iii. In the context of 'financial inclusion', the scope of financial literacy is relatively broader and it acquires greater significance since it could be an important factor in the very access of excluded groups to formal financial system. The process of educating the excluded group may invariably involve addressing deep entrenched behavioural and psychological factors that could be major barriers in inclusion strategy.
iv. In countries with diverse social and economic profile like India, financial literacy is particularly relevant for people who are resource-poor and who operate at the margin and are vulnerable to persistent downward financial pressures. With no established banking relationship, the un-banked poor are pushed towards expensive alternatives. The challenges of household cash management under difficult circumstances with few resources to fall back on could be accentuated by the lack of skills or knowledge to make well-informed financial decisions.

v. Financial literacy can help poor people prepare ahead of time for life cycle needs and deal with unexpected emergencies without assuming unnecessary debt.

vi. To have personal financial planning, a person should be financially literate to know the importance of preparing household budgets, cash-flow management and asset allocation to meet financial goals.

4.2 Financial Behaviour

Financial knowledge and financial literacy promote positive financial behaviour. To have a theoretical framework for the study of financial literacy, it is important to establish a link between financial literacy, financial education and financial behaviour to elucidate the benefits available to financially literate people. A number of financial studies show link between financial literacy and optimal financial behaviour. Annamaria Lusardi\textsuperscript{14} (2008) pioneered linking financial knowledge with financial behaviour, through the use of questions in surveys that reflect such behaviour relative to knowledge.
4.2.1. Human Behavior and Financial Decision making

Human behaviour is complex and therefore behaviour theories attempt to explain why people act as they do. Researchers concerned with behaviour change have long been interested in questions of how people seek, use and process information to take decisions. These theoretical models fundamentally guide both current and future understanding of financial behaviour (Redding et al. 2000)\(^{15}\). Financial management is a complex set of behaviours and decisions that vary in their importance and ease of implementation according to an individual’s or family’s needs, priorities, and skills. Behavioural finance combines the twin disciplines of Psychology and Economics to explain why and how people make seemingly irrational or illogical decisions when they spend, invest, save, and borrow money. Choosing the best financial behaviour for achieving financial goals is one of the most important decisions an individual should make. But it is a challenging task for the people given the current financial information and behavioural changes.

Figure 4:1 Framework of Personal Financial Behavior

Although there are a number of influences on financial behaviour, such as psychology, life experience and hardship, the most significant determinant is knowledge (Courchane, Gailey & Zorn 2008). Knowledge is the foundation of consumer behaviour, with other factors having an impact on the application of that knowledge. Thus, while knowledge and financial literacy play only a part in behaviour, this part is significant and causal to specific positive and desirable forms of financial behaviour such as financial self control. As a result, financial literacy is important because it lays the foundation for optimal financial behaviour. Financial education is necessary to improve consumer behaviour in relation to financial products and services (Mathew Martin 2005).

4.2.2 Models of Decision Making Behaviour

The question of rationality in decision making has long engaged the attention of decision theorists. Two views prevail among the scholars: - (a) man is completely rational in his decision making, and (b) man exercises limited rationality. These two types of views on decision making behaviour are based on two models of man: - economic man and administrative man.

4.2.3 Economic Man Model

Man, as a consumer, is a rational being who tries to use his or her money income to derive the greatest amount of satisfaction or utility from it. Consumers want to get "the most for their money" or, to maximize their total utility. Money is no doubt what consumers use to buy goods and services they need and in reality it is scarce in nature and an ordinary person may not have enough of it at any given time. Due to this scarcity of money, consumers tend to be rational in
their purchasing decisions. A consumer would spend his money on the best possible place or product that guarantees him optimum utility or a complete sense of satisfaction. The rational behaviour of consumer also presumes that buyers purchase goods and services only when needed rather than wasting money on things that have no immediate use. The consumer or buyer will do all he can to get the most out of the little money he has in possession in such a way that he feels satisfied about what his money has purchased for him. A decision-making process that is based on making choices that result in the most optimal level of benefit or utility for the individual is termed as rational behaviour. Most conventional economic theories are created and used under the assumption that all individuals taking part in an action/activity are behaving rationally. In relation to finance, therefore, rationality appears to mean the processes that consider economic and financial efficiency as the primary goal.

According to Herbert A Simon\(^{18}\) (1960), the steps involved in the process of rational decision making are:-

i. Recognising the problem

ii. Deciding priorities among problems

iii. Diagnosing the problem

iv. Developing alternative solutions or course of action

v. Measuring and comparing the consequences of alternative solutions, and

vi. Converting the decision into effective action and follow up.
4.2.4 Administrative Man Model- Bounded Rationality

A more realistic description of decision making behaviour is based on Administrative man model which has been developed by Herbert Simon. It is also known as Bounded Rationality Model (Herbert A.Simon1957). Bounded rationality is the idea that in decision-making, rationality of individuals is limited by the information they have, the cognitive limitations of their minds, and the finite amount of time they have to make a decision. Simon's theory of bounded rationality says that individuals do not make perfectly rational decisions because of the difficulty of obtaining all the information needed to do so. Another way to look at bounded rationality is that, because decision-makers lack the ability and resources to arrive at the optimal solution, they instead apply their rationality only after having greatly simplified the choices available.

Rationality can also be instrumental, such that it is based on utility and therefore the rational choice is what increases utility, or pleasure, wealth, profit, happiness etc. (Sandra Huston20 2010). Therefore a person behaves rationally when acting (a) in best interests, (b) while following good procedures to make decisions which (c) maximise utility, or enjoyment. In relation to finance, therefore, rationality appears to mean the processes that consider economic and financial efficiency as the primary goal. That is, for example, shopping around to find the best value financial product which provides more disposable income to enjoy life. An irrational consumer is distinguished by his or her inclination to process information in a “bad” way, by not gathering data, not testing theories and probabilities, and not comparing choices and options.
Why an individual is taking a financial decision which is optimal or suboptimal may be with social, economic, cognitive and psychological causes. Internal and external causes of suboptimal behaviours can stand alone, or influence one another. Low income can cause people to save less, or fail to plan for retirement. It can also lead to poverty, causing a lack of exposure to financial products and therefore lack of familiarity with those products.

4.2.5 Financial Behaviour and Bounded Rationality

The bounded rationality approach is much more optimistic about the impact of financial education on choice behaviour. There is much evidence to support the view that financial education affects decision making. A person more educated on financial matters, such as concepts of risks, rates of return, credit card payments structures, and household budgeting, makes better decisions, at least from the perspective of the decision maker. Moreover, educating individuals to become more literate in numeracy should reduce errors in decision making. Financial education in this case is not directed towards changing human behaviour, such as overcoming bias as defined by the conventional wisdom. Rather it is directed towards helping individuals who are bounded rational to make better decisions - decisions informed by more specialised knowledge about financial issues, markets, and products. Behavioural economics also suggests that various types of experiments and surveys can be conducted to determine how consumers would behave under different sets of informational, educational (financial literacy) and institutional settings.
A standard definition of financial literacy is “having the knowledge, skills and confidence to make responsible financial decisions.” In making rational financial decisions, the financial as well as non financial environment is also important and they greatly affect the quality of decisions. Surveys in many countries found that financial literacy is very low among individuals and households irrespective of income and education, especially among groups with lower income and less education. By contributing to financial literacy, financial education contributes to more informed and effective decisions on financial matters. Financial education and quality information go hand and hand, forming key ingredients to effective financial literacy.

As referred by Herbert A Simon21 (1978), individuals are incapable of behaving as prescribed and predicted by conventional economic wisdom. As a result, they develop heuristics, or experience-based decision-making shortcuts, to make choices that are rational even though often inconsistent with the conventional behavioural norms. It is also recognised that the typical choice environment is characterised by asymmetric information, incomplete information, and even false information and poor education. Both physiological and environmental constraints can result in errors in decision making, such as relatively poor investment decisions. Because financial environments can be changed, this approach provides a much stronger rationale for enhancing the quality of financial decision making through improvements to financial education and the decision-making environment. This would include improved access to and improved availability of quality and pertinent information,
appropriate decision making rules and regulations, and appropriate financial education.

The standard set of assumptions of the conventional wisdom is well articulated by Herbert Simon who was awarded the Nobel Prize in Economics in 1978 for his contribution to the then nascent field of behavioural economics. Herbert Simon led the way in developing behavioural economics as an analytical perspective to better explain rational human choice behaviour or decision making that is consistent with real human beings facing real world environmental constraints. He developed the concepts of bounded rationality and satisfying (as opposed to maximising) to better classify, describe, and analyse real-world choice behaviour. Key points made by Herbert A Simon\textsuperscript{22} (1955) include the notion that one’s definition of rationality must be derived from an understanding of actual human behaviours and capabilities and environmental constraints and facilitators. Moreover, benchmarks for rational behaviours need be based upon an understanding of what human agents are capable of doing in the real world modelling scenario to help identify best-practice decision-making rules to optimise human well-being or welfare. This is true in the case of financial literacy studies of economically marginalised people as their financial behaviours may not be based on any rational thinking and to a certain extent satisfying.

\textbf{4.2.6 Personal Factors Influencing Financial Behaviour}

Intelligence and cognitive ability play a key role in human functioning and the ability to process information. Important factors that contribute to human
choices include the information to which a person is exposed, and, his or her ability to process that information.

A link has been established between cognitive ability and good financial behaviour. Smith et.al\(^{23}\) (2010) found that the strong cognitive ability of people within a household has significant positive effects on the financial outcomes of the household, and in particular a strong association was established between cognitive ability, household wealth and portfolio holdings. Shawn Cole & Fernando\(^{24}\) (2008) also refer to cognitive ability as a cause of sound financial judgment.

### 4.2.7 Social Factors Influencing Financial Behaviour

Finance behaviour is influenced by social factors (Kenneth.et.al\(^{25}\) 2002). These social factors include: (a) Socio-demographics, and (b) culture. Socio-demographics are used as a proxy for other variables, which explain in greater detail why people who belong to certain socio-demographics engage in suboptimal behaviour. These variables include:- (a) employment level, (b) employment status, (c) earning capacity and (d) household and personal wealth. These four variables are significant because they lead to particular experiences and exposures, which can influence financial behaviour negatively or positively. Socio-demographics such as wealth and income determine the social networks to which a person belongs, and therefore all these social factors are relevant in financial behaviour.

The main commonality among studies is that the individuals within certain socio-demographics are financially and socially disadvantaged. This result in
people having limited exposure to finance and not being in a position to pursue education, and thus a cycle of disadvantage is evident. Linking financial literacy levels and financial behavioural patterns with particular socio-demographic groups is important, because it elucidates the impact of particular traits on literacy and behaviour. Other people, such as middle aged people, may need a particular knowledge base and experience to achieve optimal financial results. Factors such as lack of income or wealth may restrict their ability to gain valuable market experience, and the knowledge and skills that comes with that experience.

Employment results in income, the development of skills, and the maintenance of a social network. It is important to consider the value of employment to financial literacy and financial behaviour. The particular skills, social networks and level of income gained from employment depend on employment level. Employment level can therefore expose a person to particular forms of financial decision making and transactions. There is a strong link in the literature between unemployment, low income and deteriorating well being. Significant causes of financial exclusion in the UK included, among other things, unemployment and lack of personal and household income (Sarah Brown et al 2005). High income provides greater levels of disposable income which can be allocated to saving, investing and other optimal financial activities. Financial hardship has a number of causes other than financial illiteracy, such as low income or unemployment.
Wealth increases exposure to finance and this exposure enhances financial knowledge and skills gained from experience. Households endowed with larger financial assets are more likely to invest in financial knowledge. Therefore, wealth gives people the opportunity to invest and by having a greater incentive to learn about how best to manage their money; these people invest with better refined skills. Wealth, employment level, earning capacity and socio-demographic status may lead to financial experience. According to the 2001 University of Michigan, Survey of Consumers, financial experience was cited by respondents as the single most important source of financial knowledge (Chiara Monticone 2010).

Jappelli, T (2010) provides evidence that financial and economic literacy is assisted by experience with finance, by finding that the private accumulation of resources is related to financial literacy. His review of 55 countries over 1995 to 2008 showed that numeracy and the accumulation of experience in dealing with wealth created better financial behaviours and a greater familiarity with money. His study showed that people living in countries with more generous public pensions (and hence less need to accumulate resources through private saving) demonstrate lower levels of financial literacy, other things (including numeracy) being equal. Financial experience is therefore important in shaping financial behaviour. Exposure to certain social networks can result in optimal consumer decisions, due to having access to information which is inaccessible by people outside these social networks.
Those people who are members in Self Help Groups may show a good financial behaviour. The empirical analysis also revealed a positive impact of economic development and financial literacy on financial inclusion. Self Help group linkage model is one of the successfully operated models of Microfinance in India and this Model helps economic empowerment of SHG members.

4.3. The Concept of Marginalisation

Marginalisation is a relational statement. A category X cannot be marginalised in and of itself. It always has to be marginalised in relation to some other category Y, so conceptualising economic marginalisation requires an explicit statement of both X and Y; although in many cases ‘Y’ is thought of implicitly as the ‘rest of society’ or the rest of the economy. Economic marginalisation means ‘worse off’ i.e. X is worse off relative to Y, where ‘worse off’ can be measured in a number of ways covering income and non income dimensions. At other times marginalisation is taken to mean “X has got less of the increase in the pie than Y. The first statement is related to the level of inequality, the second is about changes in inequality. Ravi Kanbur of Cornell University (2007) states that “economic marginalisation as a process that relates to economic structures and in particular to the structure of market and their integration. To the extent that from the markets, some individuals or group engage in are segmented from the economy in general, these individuals can be said to be marginalised from the rest of the economy.

Some studies use the terms ‘banked,’ ‘under-banked’, ‘un-banked,’ and the ‘under-served’ to describe the extent to which people are engaged in the
conventional banking system. The terms financial exclusion and marginalisation are used to describe individuals who do not have adequate access to or information about the basic goods and services provided by the financial services sector and by governments. The un-banked and the under-banked are generally considered financially excluded, marginalised, and sometimes ‘vulnerable’ consumers. One can also find the terms ‘inadequately banked’ or ‘improperly banked’ used to describe marginalised people who have access to financial products but lack the understanding and ability to take advantage of broader services and opportunities that can be accessed through the financial services sector and to those who may have financial products that do not correspond very well with their needs and circumstances.

4.3.1 The Unorganised Sector and Marginalised People

In India the marginalised communities are urban and rural poor, scheduled tribes and castes and manual workers in unorganised sectors. There are different terminologies used so interchangeably to signify the unorganized sector like informal sector, informal economy, and even informal labour which often highlights the most affected part of the sector, namely, the labour. Informal labour is a labour whose use is not governed either by state regulations or by collective agreements between workers and employers.

The Ministry of Labour, Government of India, has categorized the unorganised labour force under four groups in terms of Occupation, nature of employment, distressed categories and service categories.
1. **In terms of occupation**

   Small and marginal farmers, landless agricultural labourers, fishermen, those engaged in animal husbandry, beedi rolling, labeling and packing, building and construction workers, leather workers, weavers, artisans, salt workers, workers in brick kilns and stone quarries, workers in saw mills, oil mills etc. come under this category.

2. **In terms of nature of employment:**

   Agricultural labourers, migrant workers, contract and casual labourers come under this.

3. **In terms of specially distressed categories:**

   Toddy tappers, Scavengers, Carriers of head loads, Drivers of animal driven vehicles, loading and unloading workers come under this category.

4. **In terms of service categories:**

   Midwives, domestic workers, fishermen and women, barbers, vegetable and fruit vendors, news paper vendors etc. belong to this category.

   In addition to these four categories, there exists a large section of unorganised labour force such as cobblers, handicraft artisans, handloom weavers, lady tailors, physically handicapped self employed persons, auto drivers, carpenters, and Urban poor.

   Major characteristics of the unorganised workers are:-

   i. The unorganised labour is overwhelming in terms of its number range and therefore they are omnipresent throughout India.
ii. As the unorganised sector suffers from cycles of excessive seasonality of employment, majority of the unorganised workers does not have stable and durable avenues of employment. Even those who appear to be visibly employed are not gainfully and substantially employed, indicating the existence of disguised unemployment.

iii. The workplace is scattered and fragmented.

iv. There is no formal employer – employee relationship

v. In rural areas, the unorganized labour force is highly stratified on caste and community considerations. In urban areas while such considerations are much less, it cannot be said that it is altogether absent as the bulk of the unorganised workers in urban areas are basically migrant workers from rural areas.

vi. Workers in the unorganised sector are usually subject to indebtedness and bondage as their meagre income cannot meet with their livelihood needs.

vii. The unorganised workers are subject to exploitation significantly by the rest of the society. They receive poor working conditions especially wages much below that in the formal sector, even for closely comparable jobs, i.e., where labour productivity have no difference. The work status is of inferior quality of work and inferior terms of employment, both in remuneration and in employment.

viii. The unorganised workers do not receive sufficient attention from the trade unions
ix. Inadequate and ineffective labour laws and standards relating to the unorganised sector.

4.3.2 The Economics of Poverty: Financial Behaviour of Marginalised People

Economist John Kenneth Galbraith\(^{30}\) (1975), states that money is equally important to those who have it and those who don’t. Stuart Rutherford\(^ {31}\) (2001) asserts that research on how poor people in the developing world manage their money shows poor people can and do save. Poor people need financial services and their need may be greater than that of the non poor. Poor people have smaller, more irregular, and often more unreliable incomes, the great bulk of which may be spent as soon as it is received on food and other consumables. When they need money to meet any exceptional situation, given that present income is insufficient, they opt to tap into past or future income. Financial services help poor people manage money in precisely that way by helping to access past income stored in the form of savings or future income by lending an advance against savings which is planned to make in future. Therefore, managing money well turns out to be a matter of managing ones capacity to save. Saving is the focal point where financial services begin and end.

4.3.3 Patterns of Financial Behaviour of Marginalised People

There are three basic patterns through which savings can be converted into useful, large sums of money for spending: ‘saving up,’ ‘saving down’, and ‘saving through’ (Stuart Rutherford\(^ {32}\) 2001). Saving up implies that savings are stored until they have accumulated into a sum large enough to serve some
expenditure need. Saving down refers to borrowing and repaying the loan. Repaying loans depends just as much on the act of saving as does saving up. The only difference is the lump sum becomes available before, rather than after, a series of savings. The savings are used as repayments on the loan - either in intervals as income is realized or after a secondary process of saving up until enough has been accumulated to pay off the loan repayment. Saving through is a mix of saving up and saving down. A lump sum becomes available at some point during a series of savings.

Researches on how poor people in the developing world manage their money show that poor people can and do save. Poor people manipulate their savings through a wide range of methods of saving up, saving down, and saving through, and they do it frequently and intensively. At the most formal end are banks, insurance companies, and NGOs. Less formal methods included savings clubs or Self Help groups, moneylenders, buying goods on credit, and obtaining wage advances from employers. At the most informal end of the spectrum are loans between family members and neighbours and keeping cash under one’s bed. Even the poorest have to spend money to buy basic items like food and clothing, and each time they do so there is the opportunity to save something, however tiny. Many poor housewives try to save in this way, even if their working husbands fail to save anything from their income.

4.4 Financial Environment and Economic Growth

Empirically, in the Indian context, Clive, Bell & Rousseau \(^3^3\) (2001) have shown how financial intermediaries in India have played a leading role in
influencing its economic performance. The financial sector, among other things, not only led to promoting aggregate investment and output but also in attaining finance-led industrialisation. Studies by Burgess & Pande (2003) Burgess, Pande & Wong (2004) have shown that rural branch expansion of Banks in India was associated with non agricultural growth and has helped in reducing rural poverty. This has been termed by some as supply-leading strategy.

Access to credit represents particularly high barriers to the ability of the poor to exploit investment opportunities. These barriers, being binding on the poor only, lead to higher income inequalities in economies with higher credit constraints (Galor, & Zeira 1993). Empirical evidence proved that access to finance is not only pro-growth but also pro poor, reducing income inequality and poverty. A broad cross country sample study observed that the income of the poorest quintile grows faster than the average per capita GDP in countries with better developed financial intermediaries (Banerjee, Abhijit and Newman, 1997). Cross-country experience also points to the higher influence of financial intermediaries on growth (measured in terms of private credit to GDP per capita and productivity per capita) growth. Hence, financial development that includes small firms and the poor disproportionately benefits those groups. For poor households, credit is not the only, or in many cases the priority, financial service they need. There are several barriers to banking services that exclude a sizeable share of the population, especially of the lower strata from using banking services (Aghion & Patrick 1997).
Fig 4.2 Theoretical Approach to Finance and Growth

A World Bank study (Beck et. al 2007) observed substantial cross-country variation in the barriers to access to banking services. By using information from 193 banks in 58 countries, the study analysed indicators of physical access, affordability and eligibility barriers to deposit, loan and payment services. The study observed that the indicators of access barriers were inversely correlated with actual use of financial services, confirming that these barriers can exclude individuals from using bank services. Barriers such as locations (bank head office, branch, other offices), minimum balance required to open account, fees associated with payments, documentation requirements, and processing times are found to vary significantly both across banks and across countries.
4.4.1 Financial Environment of the Marginalised People

The financial environment in which the marginalised people have to live can be categorised into three categories: - Formal, Informal and semi formal. Formal providers are those who are subject to the banking laws of the country of operation, provide conventional retail services to customers and engage in financial intermediation. The informal sector has commonly been viewed as unregistered sources of credit, such as money lenders and pawnbrokers Semi-formal providers are MFIs or SHGs that are usually registered or unregistered.

The financial environment of the poor and marginalised people has two features that have particular significance in shaping their use of financial services. The first feature is that they operate in a mini-economy in which production, consumption, trade and exchange, saving, borrowing and income earning occurs in very small amounts. The effect of this is that transaction costs (both direct and indirect) tend to be high as the ‘unit’ of transaction is generally minimal. This has important implications for the use of formal sector institutions where the charging of any standardised administrative cost will commonly make transactions unattractive to the poor.

The second characteristic is that there are high levels of insecurity and risk. These arise out of the fact that flow of income and expenditure commonly do not coincide, because of household-specific factors like loss of earnings through sickness, urgent medical expenses, insecure conditions of employment etc.
The consequences of these specific characteristics are:

(i) They limit the interactions of poor people with formal sector institutions.

(ii) They foster strategies of risk-spreading by the poor: these encourage diversification of economic activities and the development of financial relationships with networks of individuals, groups and agencies.

(iii) They lead to the use of savings and credit mechanisms by the poor as substitutes so that savings and credit cannot be treated as separate services.

4.4.2 Creation of Pro-Poor Financial Environment

i. Neighbourhood Groups (NHG) & Self Help Groups (SHGs)

Kerala is seeking to achieve a break in participatory poverty reduction through kudumbasree, which is implemented by the State Poverty Eradication Mission through the Panchayat Raj Systems. All urban local governments and village Grama Panchayats have been included under Kudumbasree.

Micro finance is being used as a major tool for poverty eradication. The Kudumbashree mission follows a simple model of micro finance to facilitate easier availability and better utilisation of loans for poor people.

Kudumbashree promotes thrift mobilisation by setting up Thrift & Credit Societies at Neighbourhood Group (NHG) level to encourage the poor to save and to provide them cost effective and easy credit. Self Help Groups are also popular in rural as well as urban areas. Nowadays Self Help groups are operating in almost all regions initiated by rich as well as poor people. Thrift and credit societies promoted by Kudumashree and Self help Groups facilitate easy and timely credit to the unreached. The amount of deposit, loan and the priority for
disbursement are decided by the NHG. The repayment is collected weekly during the routine NHG meetings.

ii. Linkage banking

Each NHG is linked to the Lead Bank in each district under Financial Inclusion. The bank linkage programme has helped the NHGs to augment their existing resources collected through thrift.

iii. Lease Land Farming

Lease Land Farming (LLF) is introduced to improve the livelihood of the poor families in the neighbourhood groups and increasing agricultural production by bringing fallow and cultivable waste land into agricultural use. The programme is implemented in all the districts with the support of NSGs. The activities include training and distribution of inputs and release of incentives. There are two types of incentives, namely area incentive and production incentive. Area incentive is given to cultivators based on the area of cultivation and production incentive is given to cultivators when the actual productivity is equal to or exceeds state’s average productivity.

iv. Rural Micro Enterprises (RME)

RME is specially designed for providing Self Employment Assistance to Women belonging to rural areas started during the financial year 2001-02. The minimum number of people required for a group enterprise is five. In the case of individual enterprise, maximum subsidy admissible is Rs.7500/- or 30% of the project costs whichever is less. In the case of group enterprise with ten or more members, maximum subsidy admissible is Rs.1,00,000/- or 50% of the
project cost whichever is less. If the number of members of the group is five or more but less than ten, subsidy is admissible proportionately.

v. Post office saving schemes

Besides Banks, post offices in India also provide financial services. The Indian postal services is one of the most widely spread post office systems in the world. The number of post offices is more than two times the number of bank branches in the country with large presence in remote areas. Number of post offices in rural areas far exceeded those in urban areas. Indian post offices offer various small savings and other financial services to their customers. Small savings schemes include Saving Bank, Recurring Deposits, Monthly Income Scheme, Public Provident Fund, Kisan Vikas Patra, National Savings Certificates and Senior Citizens Saving Scheme. Despite the rapid expansion of network of branches and the number of post offices, Postal financial services are yet to reach poor both in rural and urban areas.

vi. Other Major Poverty Alleviation Programmes in rural areas sponsored by Governments

The programmes implemented in the state benefiting the rural population, especially people Below Poverty Line are Swaranajayanthi Gram Swarozgar Yojana (SGSY), Indira Awaaz Yojana (IAY), Mahatma National Rural Employment Guarantee Scheme ( MNREGS)

a. Differential Rate of Interest (DRI-1972)

The DRI scheme was introduced in 1972 with the main objective of assisting poorest of poor and to bring them above poverty line. The scheme was
applicable all over India. Individuals whose family income not exceeding Rs. 18000/- per annum in rural areas and Rs.24000 per annum in urban and semi-urban areas were eligible for loans for productive purposes and for pursuing higher education by indigent students. The maximum amount of loans is Rs. 15000 as term loan or working capital or both for productive purposes and Rs. 20000 for housing. The rate of interest is 4% simple rate. The target was 40% to SC/ST and 2/3 should be through rural and semi-urban branches. Repayment period is 5 years.

b. Prime Minister Rozgar Yojana (PMRY – 1993)

PMRY was introduced to provide employment for setting up of micro enterprises by educational unemployed youth. The scheme is applicable to both rural and urban areas all over the country. Income limit is Rs. 100000. the target group is SC/ST 22.5% OBC 27% and women entrepreneurs 30%.

c. Swarnajayanthi Gram Swarogar Yojana (1999)

The purpose of the scheme is to raise individuals/groups of rural poor above poverty time over a period of time. Two scheme is funded by central and states in the rate of 75:25 and applicable in rural areas. The eligible persons are rural poor identified through BPL census only approved by Gramsabha. The largest group 40% women, SC/ST, 50% Disabled 3%.

d. Swarna Jayanthi Shahri Rozgar Yojana - 1997

The purpose of the scheme was to provide gainful employment to the urban poor living below the urban poverty line, unemployed or underemployed. It is applicable to all urban and semi urban towns. The purpose of the loan is
setting of self employment ventures. Target group is women 30%, Disabled 3% and SC/ST proportionate to strength.

e. Educational loan scheme

The scheme was introduced aiming at providing financial assistance to the poor, needy and meritorious students to pursue higher/technical/professional education. Loans are granted for studies in India and abroad.

f. Prime Ministers Employment Generation Programme (PMEGP) 2008

The scheme was launched on 10th October 2008 by merging PMRY and REGP (Rural Employment Generation Programme). The scheme is applicable to rural and urban areas with the following specific objectives:-

1. To generate employment opportunities in rural/urban India through new self employment projects/micro enterprises.

2. To bring together widely dispersed traditional artisans, rural and urban unemployed youth and to provide opportunities to the extent possible at their place.

3. To provide continuous and sustainable employment to a large segment of traditional and prospective artisans and rural and urban unemployed youth.

Any individual above 18 years of age with at least VIII standard pass is eligible. Self help groups belonging to BPL are also eligible for the loan.

g. Mahatma National Rural Employment Guarantee Programme (MNREGP)

The Mahatma Gandhi National Rural Employment Guarantee Act aims at enhancing the livelihood security of people in rural areas by guaranteeing hundred days of wage-employment in a financial year to a rural household whose adult members volunteer to do unskilled manual work.
vii. Commercial Banks

The Nation has been experimenting with various alternatives to reach banking services, primarily credit, in rural areas through several initiatives. Early initiatives in this regard were taken by building an institutional framework beginning with the focus on the cooperative credit institutions followed by the nationalization of major domestic banks and later the creation of the Regional Rural Banks (RRBs). Simultaneously several measures including establishment of the Lead Bank Scheme, directed lending for the priority sectors, banking sector’s linkage with Government sponsored programmes targeted at the poor, Differential Rate of Interest Scheme, the Service Area approach the SHG –Bank linkage programme and introduction of Kisan Credit Card were taken. Given the social responsibility to reach the rural areas and the poor, the banks and Co-operative institutions with guidance from Reserve bank of India (RBI), The National Bank for Agriculture and Rural Development (NABARD) and other apex level institutions made serious efforts in meeting the needs and demands of rural sector. As a result the outreach of Indian Banking system has been rapid growth in rural areas.

4.5. Financial Inclusion

To understand the meaning of ‘financial inclusion’, it is better to define financial exclusion rather than inclusion. Nirupam Mehrotra\(^40\) (2005) in the Report submitted to NABARD states that “A target group can be considered as financially excluded if they do not have access to mainstream formal financial services such as banking accounts, credit cards, insurance, remittances, payment
services, etc” The term financial inclusion needs to be interpreted in a relative dimension. Depending on the stage of development, the degree of financial inclusion differs among countries. In the Indian context, the issue of financial inclusion (or exclusion) along with its various facets was discussed in detail by the Committee on Financial Inclusion, (Rangarajan C. 2008). According to the Committee, “the essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings products suited to the pattern of cash flows of a poor household, money transfer facilities, insurance (life and non-life), etc”. Thus, it is clear that the objective of “Comprehensive Financial Inclusion” is to provide a whole gamut of financial services. However, in a restricted sense, financial inclusion can be achieved if some of the financial services, to start with credit, can be offered. Although, having a bank account may not be a good indicator of financial inclusion, nevertheless, it is a basic formal banking service, which “confers a sense of identity, status and empowerment and provides access to the national payment system”. The Committee has also provided a working definition to Financial Inclusion as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.
4.5.1 Significance of Financial Inclusion

It is now widely acknowledged that financial exclusion leads to non-accessibility, non-affordability and non-availability of financial products. Limited access to funds in an underdeveloped financial system restricts the availability of bank funds to individuals and also leads to high cost credit from informal sources such as moneylenders. Due to lack of access to a bank account and remittance facilities, the individual pays higher charges for basic financial transactions. Absence of bank account also leads to security threat and loss of interest by holding cash. All these impose real costs on individuals. Prolonged and persistent deprivation of banking services to a large segment of the population leads to a decline in investment and has the potential to fuel social tensions causing social exclusion. Thus, financial inclusion is an explicit strategy for accelerated economic growth and is considered to be critical for achieving inclusive growth in the country.

Limited access to affordable financial services such as savings, loan, remittance and insurance services by the vast majority of the population in the rural areas and unorganised sector is believed to be acting as a constraint to the growth impetus in these sectors. Access to affordable financial services - especially credit and insurance - enlarges livelihood opportunities and empowers the poor to take charge of their lives.

According to Usha Thorat\textsuperscript{42} (2007), Financial Inclusion is considered to be critical for achieving inclusive growth; which itself is required for ensuring overall sustainable overall growth in the country.
4.5.2 Financial Exclusion

Financial exclusion would mean the inability of the disadvantaged to access financial services. A wide range of obstacles could lead to financial exclusion; barriers include geography (limiting physical access), regulations (lack of formal identification proof or of appropriate products for poor households), psychology (fear of financial institution’s staff, structures, complicated financial products, etc.), information (lack of knowledge regarding products and procedures). The financially excluded sections largely comprise marginal farmers, landless labourers, self employed and unorganised sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women.

Regardless of financial literacy levels, a particular person may be financially excluded such that literacy cannot be acquired, or even if such literacy is acquired, that person cannot use their knowledge and understanding. Financial exclusion is reached where a proportion of the population have limited access to mainstream financial services. Exclusion also relates to limited access. Almost all the economically marginalised sections of the society which exhibit less desirable financial behaviour have one thing in common: lack of wealth.

There are nine types of exclusion in financial market:-

1. *Self exclusion* or voluntary non-use- It occurs when certain individuals choose not to use a formal financial service, despite a need, perhaps due to past refusal, negative word of mouth, confusion, or lack of trust’. Self
exclusion or voluntary non-use can also be due to cultural or religious reasons.

2. *Access exclusion*- which includes restrictions on access to financial services due to such things as branch closures and unfavourable risk assessments.

3. *Condition exclusion* - which causes exclusion due to conditions attached to the offering of products, which may focus on particular individuals.

4. *Price exclusion*- occurs where people cannot afford particular products or services.

5. *Marketing exclusion* - which results from financial firms overlooking certain groups in its marketing activities;

6. *Resource exclusion* - which includes instances where a limited family income prevents a family from saving. This does not reflect lack of understanding or desire, but lack of possibility and opportunity. This has also been called *income exclusion*.

7. *Geographic exclusion*, people tend to take advice from those around them, such as family or friends, this creates a cycle of reliance on poor advice which generates financially vulnerable pockets of the community.

8. *Market and economic complexity*- Complex markets and financial products can leave consumers feeling overwhelmed and confused. One leading cause of financial exclusion, other than wealth, is the use of complicated language in financial products.

9. *Culture of consumerism*- An important social influence on financial behaviour is culture and technology. In particular, this also includes a culture
of short term consumerism which reduces the inclination to save and plan for the future. For example, the Commonwealth Financial Literacy Taskforce found that ‘teenagers from Generation Y are more likely to have debt management problems associated with mobile phones than their parents as teenagers who did not have mobile phones or the same opportunities for credit. In a study of the financial behaviour of young women, it is found that easy access to credit has created a culture of increased spending and indebtedness. Societal pressures therefore impact consumerism, and as a result, consumerism influences the amount of disposable income available for saving and investing.

4.5.3 Financial Literacy and Financial Inclusion

Reserve Bank of India treats financial inclusion and financial literacy as twin pillars. Financial literacy stimulates the demand side by making people aware of what they can and should demand. Financial inclusion acts from the supply side by providing in the financial market what people demand. (Subbarao, D 2010). The Reserve Bank traditionally focused more on addressing financial exclusion through many supply-side measures so as to help “connect people” with the banking system, But they now recognize the demand side imperative also so that financial literacy and education should be developed hand in hand with improving access to financial services.

“What we need is a two-step financial literacy programme to make financial inclusion successful and meaningful. One is developing personal financial management skills and the other is developing financial operation skills
for availing various financial services. Personal financial management literacy includes the component of awareness building for financial planning and changing impulsive financial decisions, understanding importance of regular savings, borrowing only for productive purpose, minimising risks through availing insurance services and also understanding financial principles” (Jayshree Vyas\textsuperscript{44} 2011).

According to Usha Thorat\textsuperscript{45} (2007), financial empowerment is not only about financial inclusion but it also means financial literacy. Delivering the inaugural address at the International Workshop (RBI & OECD,2010)\textsuperscript{46} on ‘Delivering financial literacy: challenges, strategies and instruments, organised jointly by the Reserve Bank of India and the Organisation for Economic Cooperation and Development (OECD), Indian Union Finance Minister Pranab Mukherjee observed that “Financial literacy is a prerequisite for effective financial inclusion, which will ensure that financial services “reach the unreached and under-reached sections of the society,” Mr. Mukherjee said efforts to improve financial literacy should take into account India's divergent and multi-lingual framework, wide divergence in literacy levels across States and within States and the marked differences between rural and urban areas .

According to Jayshree Vyas\textsuperscript{47}, financial literacy is a primary step for financial inclusion since introspection changes behavior which in turn makes people seek and receive financial services and products.

Financial literacy can lead to financial wisdom as it brings following benefits to individuals (Imran Matin\textsuperscript{48} 2002):-
• Ability to manage money not just deals with it.
• Ability to use skills to take wise decisions for the future
• A financially literate person can link her need for a product or service with those available within the banking system.
• A demand for financial inclusion is created through an appreciation for what is available.
• The formal banking system will find a financially literate person easier to approach.
• Financial literacy empowers the poor and women
• A financially literate person will seek information about available services to operationalise financial decisions and hence access what is available.
• Financial literacy builds capacities to make decisions and take responsibility for those decisions.
• It increases the economic space poor and women
• Linkage to formal financial systems mainstreams poor producers.
• Self esteem increases when their productive lives include mainstreaming into formal systems.

4.5.4 Financial Literacy and Economically Marginalised People

A fundamental question is what exactly financial literacy is and do the poor or marginalised really need it or want it. The marginalised has little money. “When you have so little, you have to become an expert at managing it. If not, it will disappear from your hands before you even had the time to count it” (Grameen foundation 2010).
“In a country like India, with diverse social and economic profiles, financial literacy is relevant for people who are resource poor and who operate at the margin and are vulnerable to persistent downward financial pressures. A financially secure country cannot be built on the base of small proportion of financially secure households. Inclusive growth, which is our objective, requires the participation of everyone, rich or poor, in the growth process and sharing the growing prosperity. With Indian growth increasingly becoming investment driven, it is important to make potential savers and investors and ‘financial literates’ so that more people can contribute to economic growth. Financial literacy needs to be embedded in our way of life. Everyone who earns an income is a potential saver; every saver is a potential investor, every investor ought to be financially literate” (Chidambaram, P. 2010).

Financially literate people should make better decisions for their families, increasing their economic security and well being. Secure families are better able to contribute to vital, thriving communities, further fostering community economic development. They are in a better position to obtain better jobs and create a desirable pool of labour for employers. Secure families are more involved in their communities as home owners and voters.

Financial literacy is considered an important adjunct for providing financial inclusion and ultimately financial stability. Both developed and developing countries, therefore, are focusing on programmes for financial literacy. In India the need for financial literacy is even greater considering the low levels of and the large section of the population, which still remains out of
the formal financial setup. In the context of financial ‘inclusion’ the scope of financial literacy is relatively broader and it acquires greater significance since it could be an important factor in the very access of such extended groups to the finance. In countries with diverse social and economic profile like India, financial literacy is particularly relevant for people who are resource poor or who operate at the margin and are vulnerable to persistent downward financial pressures. With no established banking relationship, the unbanked poor are pushed towards experience alternatives. The challenges of household cash management under difficult circumstances with few resources to fall back on could be accentuated by the lack of skills or knowledge to make well informed financial decisions. Financial literacy can help them prepare ahead of time for life cycle needs and deal with unexpected emergencies without assuming unnecessary debt.


Limited access to or limited use of financial services generates persistent poverty traps. Thus financial exclusion can act as hindrance to economic growth. Financial exclusion can be voluntary chosen or involuntary suffered. In the case of voluntary exclusion, non-users of financial services have access to, but do not use financial services either because they have no need for those services, or because they decide not to make use of such services due to cultural, religious, or other reasons, i.e. using financial service is not restricted by availability but by low levels of demand (Honohan 2008). In case of
Involuntary exclusion access is always restricted and supply fails to meet demand.

Involuntary non-users want to use financial services, but do not have access due to a variety of reasons: First, they may be unbankable because their low income prevents them from being served commercially (i.e. profitably) by financial institutions; second, they may be discriminated against based on social, religious, or ethnic grounds; third, they may be unbankable because contractual and informational networks prevent financial institutions from commercially serving these non-users; finally, the price or features of financial services may not be appropriate for the population groups of the non-users.

The theoretical base of the study is that when the financially excluded poor or marginalised people become financially literate, they will have ‘saving up financial behaviour’ by using the most formal financial service providers. This highest level of financial literacy can be achieved by financial education and training (Classen, S. 2006). Inclusive growth is possible only through deliberate interventions for changing the bad financial behaviours of economically marginalised people as inclusive growth, which is our objective, requires the participation of everyone, rich or poor, in the growth process and sharing the growing prosperity (Shawn Cole 2009).

**Figure 4.3. Theoretical Base of Financial Literacy**
There is an implicit assumption that increases in information and knowledge will lead to change in financial management practices and behaviours. “Well-informed and well-educated consumers can create economic ripples” opines Jeanne M. Hogarth of the US Federal Reserve Board in her paper, ‘Financial Education and Economic Development presented at the Financial Literacy International Conference’ (2006). The author further states that “they make better financial decisions for themselves and their families, increasing their economic security and well being and these economic ripple effects can be significant. Drop a rock into a lake or pond, the ripples extend outward with wider and wider effects. So it is also with financial education.”

A comprehensive financial education approach should include the following themes:

(1) Being knowledgeable, educated, and informed on the issues of managing money and assets, banking, investments, credit, insurance, and taxes;
(2) Understanding the basic concepts underlying the management of money and assets (e.g. time value of money in investments and pooling of risks in insurance); and
(3) Using that knowledge and understanding to plan, implement, and evaluate financial decisions.

This implies that the outcome of financial education, that is, what a ‘financially educated’ person does include behaviours such as paying bills on time, having manageable levels of debt, setting financial goals and having a way of achieving those goals through saving and investing, spending wisely, and so
on. The specific execution of these behaviours may vary with income, personal family circumstance, and asset level. Individual behaviours can and should have ripple effects beyond the realm of an individual household. Having one's financial house in order can lead to stability of family life, which can contribute to stable educational situations for children, and more involvement of family members in their community. These far reaching benefits of financial literacy will be translated into the country's real economic growth and financial stability.

In a research done by Hogarth, Hilgert, and Schuchardt\(^5\) (2002), it is proved that the higher a consumer's financial knowledge, the higher the probability that the consumer undertakes more positive financial management behaviors and uses more financial products and services. Individuals need to apply what they learn to their lives, families and situations. When individuals learn to cultivate a responsible saving, spending and investment attitude, and do the right thing, the positive ripple effects extend to and can strengthen a country's economy.

### 4.7 Measurement of Financial Literacy

Financial literacy is typically an input to model the need for financial education and explain variation in financial behaviours. Defining and appropriately measuring financial literacy is essential to understand educational impact as well as barriers to effective financial choice. To assess current levels of financial literacy and explore means to improve it, a construct is needed to measure consumers' ability to make effective financial decisions. Despite its importance, the academic literature has given little attention to measurement of financial literacy.
For the purpose of analysing financial literacy of the marginalised people, data were collected concerning six areas of financial literacy; Numerical literacy, general financial awareness, saving literacy, spending literacy, borrowing literacy and investment literacy. Numerical literacy and General financial awareness were not counted to measure financial literacy. All the respondents scored full in answering the questions on basic arithmetic and so this dimension was not included. Since the conceptual base of the study is financial behaviour (Financial knowledge + financial action), awareness of general financial terms is not included to measure financial literacy of the marginalised people.

A challenge to understand the importance of financial literacy is its measurement. There is no standardised measure or determinants of financial literacy. For the purpose of the study, a model is developed by the researcher to measure the overall financial literacy.
Financial literacy = saving literacy + Spending literacy + Borrowing literacy + investment literacy

4.7.1 Numerical Literacy

Many studies on financial literacy start with questions first popularised by Annamaria Lusardi consisting of arithmetical questions related to additions, multiplications and divisions. Financial literacy test scores are highly correlated with arithmetic test scores suggesting that financial literacy tests may partly measure an innate or acquired ability to solve numerical problems in general. In a study conducted by Shawn and Bilal\textsuperscript{56} (2009) to examine the reason for low demand for formal services in emerging markets of India and Indonesia three numerical questions used by Lusardi and Mitchell\textsuperscript{57} (2006) were asked.

The measured financial literacy is low in India. The mean correct answers were 52% in Indonesia and 34% in India. There is also substantial variation by wealth and cognitive ability. The study found that cognitive ability plays an important role in determining financial literacy. This finding is consistent with the findings of Shown Cole and Shastry\textsuperscript{58} (2009) which finds close relationship between cognitive ability and financial behaviour in the United States.

The ability of a poor person to count his earnings, to check the purchase bills, counting the balance cash received from a shop, calculation of simple interest on his borrowings or deposits etc are strong indicators of financial literacy. To some people financial literacy is arithmetical literacy. Additions, subtractions, divisions and multiplications are basic arithmetical skills needed
for an individual for easy dealings in money in daily life. Kerala is having the highest literacy rate of 93.91% as per 2011 Census. (Census Report 2011)\textsuperscript{59}.

4.7.2 General Financial Awareness

The retail financial service industry is moving towards a perennial problem, i.e., information asymmetry. In modern world, many financial services are available to the consumers whether rich or poor. One of the consequences of limited financial literacy is limited financial market participation. Households that are not familiar with the workings of a bank are unlikely to open a bank account and may choose to store cash at home or invest in other stores of value such as gold. The awareness and use of financial services determine the level of financial literacy. This awareness may be categorised as follows:

i. Banking awareness

Commercial banks offer many services to the public like savings account, fixed deposit accounts, current accounts, recurring deposits and also loans and advances facilities of various form in addition to technology integrated services. Opening of a saving account with a nearby commercial bank or co-operative bank and being a customer indicates a high level of financial literacy than dealing with a local money lender or informal financial service provider. Awareness and use of banking services is more relevant in the context of financial inclusion programme by RBI since 2006.

ii. Capital market awareness

Familiarity or knowledge of shares, bonds, mutual funds, etc and dealings in stock exchanges add to a person’s financial literacy. The financial literacy
will be high if the person is dealing in capital market instruments either as seller or as buyer without incurring much loss. This dimension of financial literacy may not be relevant in the context of marginalized people as their participation in capital market activities is very low. For the rich, knowledge and participation in capital market dealings is a strong indicator of financial literacy.

iii. Awareness of Government sponsored schemes

Awareness and use of Government Sponsored Schemes is another indicator of financial literacy. There are several schemes and programmes being implemented by the government and also by Non Governmental Organisations (NGOs) to enhance the livelihood systems of the poor and marginalized. Input-output analysis of the performances of various schemes is not yet conducted by any agencies. The implementing agencies satisfy with the delivery mechanisms and the quantity of amounts disbursed rather than the impact of these sums on the quality of life of the beneficiaries. There also exists an information asymmetry regarding these schemes which contributed to higher levels of financial illiteracy especially among the marginalised people.

iv. Subsidised price shops

Subsidised retail price shops sponsored by Government are quite common today. Through retail ration shops (Public Distribution System) subsidized food articles are supplied to the public who are categorised into BPL (Below Poverty Line) category and APL (Above Poverty Line) category. Rice, wheat, sugar, kerosene, provisions etc are supplied to the eligible people at subsidised prices through the retail shops. Knowledge and use of these facilities contribute to
higher level of financial literacy as it results in less consumer expenditure contributing to savings. Government of Kerala is also offering subsidised provisions, medicines etc through Supplyco, Consumerfed shops, Maveli shops, Neethi stores etc. This facility is open to both rich and poor people. Awareness and use of this facility is an indicator of financial literacy since it has a positive impact on family budget.

vi. Social security schemes

Social security schemes like insurance, pensions etc are more popular in India. LIC is a household name. Since liberalization many private sector insurance companies are active in this field. Insurance is considered to be an area of rich people. But there are insurance schemes introduced by government aimed at the social security of marginalized people like micro insurance, health insurance etc. Awareness and participation in the insurance schemes by the target group for which these schemes are introduced is a strong indicator of financial literacy.

vii. Self Help Groups

There is an onslaught of self help groups, neighbourhood groups (Kudumbashree, Janashree etc) both registered and unregistered all over the states in India. These social groups work for the benefit of members. Microfinance is another area of recent development. Non-governmental organisations by organising self help groups and micro finance groups are also involved in financial empowerment of marginalised people. Political and religious organisations are also competing among themselves to uplift the poor
and marginalised by starting their own micro organizations and support units. Many recent studies found that these organisations empower the poor economically and thus having a positive impact on financial literacy.

4.8 Saving Literacy

Saving is the portion of disposable income not spent on consumption of consumer goods but accumulated or invested directly in some financial or real assets by an individual. Individuals are in charge of their own financial security (Annamaria Lusardi 2008). Saving presupposes surplus personal income either from any occupation or profession. The amount of money needed by an individual and his family to live in this modern world is a question of fact. It is relative to the family’s socio-economic situation. Income is earned from occupation, profession, agriculture or business.

Salary is the monthly remuneration given to an employee by an employer for the services rendered by the former. Employees are assured of their salary in a month provided they satisfy the employment conditions. Therefore, it is a regular income so long as the employee is in service. Usually, it is given after compulsory deductions like professional tax provident fund; Employees State insurance, income tax etc.

Wages are calculated daily by the employer, though paid in weekly or monthly intervals. Wages are given to labourers and not to employees. If a person is not working on a day, he will not get wages. It is directly proportional to a person’s ability, willingness and availability for work. Provident Fund, ESI,
etc are deducted from the wages of Factory labourers, but this is not applicable in the case casual labourers

Earning personal income either from salary or from wages cannot be stated as the sole indicator of financial literacy. Earning an income is a must for an individual’s livelihood. The knowledge that salary gives oneself more financial security than wages may indicate the presence of higher levels of financial literacy. It can generally be stated that the level of financial literacy will be high if the income earned is effectively used for having a quality life (better living condition, adequate savings etc)

Income from agriculture and allied activities is another source of income for the people. Marginalised people may not have substantial cultivable agricultural land. A few of them may engage in farming on lease basis. Nowadays, self help groups are actively engaged in joint farming under their banner and share the profit among them.

An individual can legitimately earn income from other sources in addition to income from salary or wages or from agriculture. Earnings from other sources depend on the mindset of the people. The saying is ‘money begets money’. The salaried group may use their net savings in constructing one or two houses, investing in shares/bonds or deposit surplus in banks. All these investments may again earn further income.

In case of marginalised people additional income can be earned by sale of live stocks (cows, goats, chicks etc) which they keep and feed in their home. They may also engage in self employment schemes like street vending of
vegetables and fish, lottery sales etc. In the case of marginalized group, a strong financial literacy will be present if they mobilise money from sources other than normal earnings.

Finance or money is the medium with which we buy goods and services for our existence. Gone are the days of barter where people exchanged goods for goods. Earning money means engaging in an occupation and getting money in the form of salary or wages or profit. Money earned by an individual can be used for earning more money by wisely deploying the net savings in profitable avenues. In the case of poor households, livestock farming is a common form of mobilizing money. Mobilizing money over and above the normal form of earnings is a strong indicator of financial literacy.

4.8.1 Individual Savings

Saving is the excess of income over expenditure. A high level of savings helps the economy to progress on a continuous growth path. Savings is the sacrifice of current consumption to be able to consume in future. Households have varying needs of which some must be satisfied immediately, but other needs occur in future, some of which are planned and some unforeseen. To satisfy the future needs money need to be saved. Presence of savings determines the magnitude of financial literacy among the saving category.

Given the importance of savings, there have been extensive studies on the behavioural and other factors which influence savings. “When the poor have a choice, they choose to save. Saving safely provides them with a cushion against shocks. Even today around 100 million households have informal savings which
are outside the fold of formal financial system. Tapping the informal savings of the poor and using of these resources for development is necessary. Designing deposit products appropriate to the needs of the poor, ensuring convenience and developing mechanisms to mobilise the informal savings is needed” (Sukhdeve, M. L. 2008)61.

4.8.2 Factors Determining Savings of Households

Saving is influenced by several variables like the perception about saving, assessment of its costs and benefits, age, family size and structure, objectives or motivations for saving, economic environment etc. For some, saving is money reserved for future needs, whereas for some others it is surplus of income over expenditure and for still others it is purchase of land, construction of buildings, consumer durables or other household goods. When saving is perceived as money reserved for future needs it implies a deliberate decision behind saving. This deliberate decision on the part of the households to save for meeting the future needs depend on many factors .

i. Age

Age of an individual is one of the crucial factors in determining the rate of savings. The households’ saving ratio and the relationship between its current consumption and its accumulated assets will depend upon the age. According to the Life Cycle Hypothesis (Modigliani Franco 1963)62. ‘The average propensity to save for the given age group is assumed to be the same for all income levels, which is expected to rise with middle years, and fall again upon retirement. During the middle years income is likely to be high, most of the consumer
durables have been acquired and there is the anxiety of a fall in the income upon retirement. These factors cumulatively account for a rise in savings during the middle years.

ii) Number of dependants

The dependents absorb a large portion of the resources potentially available for increasing the stock of physical and human capital. Thus dependency ratio has a negative effect on the savings of the households. The birth rates should be inversely related with a country’s saving potential. The inverse relation between savings and dependency ratios is because children increase the need for expenditure which is considered as consumption expenditure. Hence a high dependency ratio imposes a constraint on the society’s potential for savings (Leff Nathaniel H.1969)\textsuperscript{63}.

iii. Gender of children

The savings of the households are supposed to be positively related to the number of female children. But the number of male children in the household is likely to have a negative effect on the saving of the household. This is because male children serve the function of an economic asset or are regarded as such. Households with more male children are likely to have a lower demand for other forms of wealth. Male children look forward to higher rates of labour force participation and higher lifetime earnings while females require huge expenditure for marriages and related activities. Male children are expected to support parents in old age. They can be regarded as long term assets which, to some degree, might satisfy the household desires for wealth accumulation.
iv. Education

One variable, which has an association with savings of the households, is the educational status of the households. There seemed to be a direct correlation between the number of regular saving and the education of the head of the household (NCAER. 1964)\(^64\).

v. Number of earners

Another crucial factor determining the level of savings of the households is the number of earners in the households. Other things remaining the same, the number of earners governs the income of the households while the number of non-earners or dependents will affect the ratio of consumption to income.

vi. Occupation

The occupation of the head of the household is a factor affecting the saving differentials between households. Occupation has proved to be a good variable for estimating permanent income.

vii. Need for liquidity

Another factor which influences savings is the need for liquidity to meet the exigencies of life (Gene Amromin 2005)\(^65\). The saved corpus acts as a buffer against the same. Since preliminary savings needs to be liquid, they are often held in the form of non-productive assets like cash, gold jewellery etc.

viii. Life time expenditures

A critical factor influencing savings in low income countries like India is life time expenditure like housing, consumer durables and sometimes for setting up small business (Prema Chandra and Kunal Sen2002)\(^62\).
ix. Income level and income uncertainty

Empirical research underlines the fact that savings ratios are low where income is low or near to subsistence level. Very low per capita incomes render it almost impossible for households in underdeveloped and developing countries to save. Average savings ratios rise as household income increases beyond the base minimum required for survival.

x. Consumer behaviour

Saving and consumption are inversely correlated, which means anything that increases consumption will reduce saving. When households increase their consumption expenditure disproportionate to income, the ability to save will be affected.

xi. Inflation

Household saving also responds to the rate of inflation in a country. Higher inflation rate tends to lead to quantitatively high household income. But in the case marginalised and impoverished people, inflation as reflected in the form of rising prices, may cause depletion in their savings as the cost of living rises with given steady daily income (Mason, A. 1988)\textsuperscript{67}.

xii. Pro-poor financial policies

A well-developed pro-marginalised financial system brings poor people into the mainstream of the economy and allows them to contribute more actively to their personal economic development (United Nations 2005)\textsuperscript{68}. Access to financial services allows lower income groups to save money outside the house safely. Pursuant to the process of globalization, the economic and financial
landscape of India has undergone significant transformation. The economy has become more diversified with the new avenues of development. As market advances continue in the complex financial landscape, it becomes important for consumers to have improved access to information (Reddy, Y.V. 2006).

xiii. Social welfare schemes

In recent years, the number of social welfare and security schemes aiming at marginalised people has increased significantly. These schemes augment the delivery side of money to these sections of people which will increase the money supply in their hands.

xiv. Cultural factors

The issue of culture in savings attracted many questions and discussions in the economic debate. In developing countries cultural aspects are important in decisions to save. Culture is a system of basic common values that help shape the behaviour of people in a given society. Culture includes beliefs, morals, laws, customs, opinions, religion and superstitions (Granato, J 1996). Savings and cultural aspects have a strong correlation in the literature of informal savings mechanisms (Robinson, M. 2001).

4.8.3 Savings of Marginalised People

Poor households save in various forms, for reasons and purposes specific to their needs and entrust their monetary savings to different persons or places like neighbours, financial institutions, under mattress etc. Many emergencies or opportunities necessitate instant access to cash, and this explains why almost all
low income and poor families keep some amount of emergency savings in the home. Low income households save when:-

1. they feel that their savings are secure,
2. the amount of their savings are kept secret to others,
3. they can access all or part of their savings when needed,
4. they have the possibility to save often and easily,
5. they are entitled to obtain a credit (reciprocity),
6. they feel under some social pressure to save,
7. they know at any time how much they have.

When the poor have a choice, they choose to save (Sukhdev, M.L 2008). A study in India conducted by NCAER and Max New York Life found that:-

1. 81% of the households save,
2. 1/3 of the population prefer to keep cash at home,
3. 49% are outside the coverage of formal banking system,
4. 58% of labourers keep cash at home.

Formal financial institutions frequently ask question as to how can marginalised households save as they are the potential deposit receivers. However, research proved that the poor household wants to save and do save, but it is not easy. They save in kind or in cash to provide for difficult periods. Studies found that this segment of the population save because they have particular reasons or motives to do so. Different households had different reasons for keeping away some money as savings ranging from emergencies to
marriage and social events, education of children and gifts. Saving for old age is not the important drive for setting aside some cash. The priorities of households for using their savings as per the NCAER – Max-New York Life Survey (2008) findings are:-

1. 81% for education
2. 69% old age family security
3. 63% to meet future expenses like marriage, births and other social ceremonies.
4. 47% to buy or build houses.
5. 47% to improve their business
6. 22% to buy consumer durables
7. 18% for expenses towards gifts and donation

Secure and accessible saving is the primary necessity for anyone seeking to manage a household budget. Saving is essential in one form or another, by everyone even if the amount is very small. Saving in cash at home has the advantage of liquidity and accessibility, but as it is exposed to chance of theft or being frittered away, it is not the preferred choice.

4.8.4 Saving Skill and Financial Literacy

There is an increasing array of literature proving that poor and marginalised people can and do save in a variety of ways. Like any other person in the society, these people value access to these savings when needed (Hirchand Madeline, 2003). Presence of savings by a poor family is a strong indicator of financial literacy. The literacy level depends on where money saved is kept,
whether in formal, semi formal and informal sector. It also varies according to the availability of formal and informal mechanisms (Moulick Malharantika, 2008)\textsuperscript{75}.

4.9 Spending Literacy

The economic status of a society or community refers to its position as to where it stands on the ladder of financial position. The important determinants of economic status of a society are its per capita income, the standard of living, the level of consumption etc. The standard of living of a household can be understood from the consumption pattern, and the quality of domestic spending clearly indicates the level of welfare of the household. Domestic spending can broadly be classified into:

i. Food and non-food consumption

Domestic spending categories are formed mainly on the basis of the nature of commodities involved. Broadly speaking there are two categories: food and non-food consumption. Consumption to gratify hunger and thirst needs is food consumption. The consumption that is not related to above but meant for satisfaction of health, education, travel and recreational needs is regarded as non-food consumption.

ii. Primary and secondary consumption

This classification is purely based on the types of needs. According to this classification we can distinguish between essential or primary consumption and non essential or secondary consumption commodities. Primary consumption involves the fulfilment of needs that arise out of physiological bodily functions
like thirst and hunger. These needs are also called biogenic needs. Considering the basic nature, the needs for shelter, clothing, health and education can also be included in the category of primary consumption. The secondary consumption comprises the gratification of a more sophisticated structure of physiological needs which relate to social, cultural and intellectual interests. This classification of consumption into two categories remain inconclusive because human needs are of varied nature and subject to individual consumer behaviour.

4.9.1 Factors Influencing Domestic Spending

i. Income

Family income is an important factor for determining the range of domestic consumption options, especially as economies become increasingly monetized. Income gives people the ability to buy diverse and nutritious foods, to pay for motorized transport instead of walking, to pay for quality health care and education for their families, to pay for latest fashionable costumes or electronic goods, to have latest branded mobile phones etc. When income rises steadily, consumption also rises for most of the population. But for the same reason, when incomes declines, consumption also falls sharply, with devastating consequences on human well being.

ii. Infrastructure

Domestic spending also depends on the range of goods and services available from the market and those provided by the Government. Many of the most basic essential goods and services-water, education, health care, transport, communication and electricity-cannot be provided without infrastructure. These
services have been provided first by the state. But recently, these services are being increasingly provided by the private sector in areas where profit can be made.

iii. Information

Information is the key to raising awareness of the range of consumption options available and enabling the consumer to decide which choice is best. Without information, there is no way of knowing what goods and services are available in the market and what services are being provided by the state and are by right, available to all.

iv. The household- decision-making

Domestic spending decision making is either by mother or father or jointly. The education and upbringing given to children play a critical part in deciding the range of domestic spending.

v. Globalisation

Day by day, as a result of globalisation, the definition of what constitutes a 'necessity' is changing, and the distinction between luxury and necessity is becoming thin. Globalisation is integrating not only trade, investment and financial markets but also integrating consumer markets around the world. This has two effects -economic and social. Economic integration has accelerated the opening of consumer markets with a constant flow of new products. There is fierce competition to sell goods and services to people worldwide by increasingly aggressive advertising.
As a consequence, a host of consumption options have been opened for many consumers - but many are left out because of lack of income. Pressures to match the consumption of a next door neighbour or to pursue the lifestyles of the rich are on the increase especially on those who cannot afford such products or services. When there is heavy pressure to maintain high standards and society encourages competitive spending for conspicuous displays of wealth, inequalities in society deepens in the form of poverty and social exclusion.

4.9.2 Nature of Spending Habits

Consumer spending habits can be categorized into regular spending and lifestyle spending. Regular spending includes the basic necessities of life, while lifestyle spending includes spending on a computer, internet, car, cell phone, etc.

Analysis of consumer spending reveals that the average consumer has been spending on an increasing number of different goods. There are a number of factors affecting the consumer spending pattern; these include growing income levels resulting in more disposable income with individuals, changing attitudes towards consumption, changes in prices, introduction of new products, availability of credit such as loans, rising aspiration levels, increased literacy, growing brand consciousness and rapid urbanisation.

Spending habits are different for people belonging to different sections of society. For instance people belonging to the middle class consider basic necessities and education and spending toward the future of their children as their top priorities, followed by lifestyle goods. The rich class spends more on luxury goods and international brands. The super rich class spends on ultra
luxury goods. It is observed that as disposable income increases, people prefer more of branded goods, shift to processed foods, and the expenditure on food, beverages, tobacco, and transport and communication also increases.

Shopping habits of people in Kerala are also changing due to their growing disposable income, relative increase in the younger population, and the change in attitudes towards shopping. The emphasis has changed from price consideration to design, quality and trendiness. The desire to look and feel good is also a guiding factor for customers while making their purchase decisions.

4.9.3 NSS Survey on Consumer Expenditure 66th Round-2009-10

On 8th July 2011, the National Sample Survey Office (NSSO, 2011) released the key indicators of household consumer expenditure in India based on data collected in its 66th round survey during July 2009 - June 2010. NSS surveys on consumer expenditure are conducted quinquennially (every 5th year) with the last quinquennial survey conducted in NSS 65th round (July 2004 - June 2005). The NSS 66th round was the eighth quinquennial round covering 59,097 samples in 7,428 villages and 41,697 samples in 5,263 urban blocks. The survey assumes heightened significance as India relies on it to measure income growth across the country, in the absence of an official income survey. The survey brings to light, the prevalence of the deep urban-rural divide in terms of consumption spending (and hence, income). Per capita spending of urban India was almost double that of rural India.

This disparity is further accentuated by the stark inequalities that exist amongst states, as evidenced by the survey. The rural average Monthly Per
Capita Expenditure (MPCE) in Kerala was INR1835. While that in Bihar was only INR780. The survey also investigates the composition of the household consumer expenditure basket in terms of food and non-food items. Share of food was 57% in rural India and 44.4% in urban India.

The survey’s examination of MPCE across different states adds another dimension to the consumption disparity in India and sheds further light on the urban-rural divide at the state level. Among the major states, Kerala (INR1835) had the highest rural MPCE followed by Punjab (INR1649) MPCE in 6 states was higher than the national average, led by Maharashtra (INR2437) and Kerala (INR2413 followed by Haryana, Andhra Pradesh, Punjab and Karnataka.

The survey also concludes that consumers spent more on non-food items such as durables and services. Share of durables rose from 3% to 5% for the rural population and from 3% to 7% in urban areas since 1987-88. The 10 percentage point rise in expenditure of non-food items by the rural population since 1987-88 can be viewed as another indication of economic growth benefiting rural India. At the state level, the food share ranges from about 46% and 40.2% in Kerala to about 65% and 53% in Bihar and Assam for the rural and urban populations respectively. An inverse relationship is noticeable between average MPCE of a state and share of food in total consumer expenditure. States with low average MPCE tend to have higher food share and vice versa.
4.9.4 Importance of Family Budget in Financial Literacy

A budget is a written plan of action covering projected activities. It is a monetary statement prepared for a future period of time with the objective of efficient utilisation of the available fund. Though budget is often considered as a Governmental or business term, the budgeting principles can also be applied in personal financial matters. A family budget can be stated as a projected statement of income and expenditure of a family prepared by the family head for a specific period, usually for a month. The sources of income and items of expenditure are shown in detail.
Budgeting for family income and expenses is often a least priority for poor families. Without budgeting, however, family living expenses may exceed the available income and jeopardize the overall financial goals of the family. Budgeting for family expenditures is the foundation of a sound financial management plan. When used in conjunction with records of actual spending, a family budget allows a family to pinpoint unnecessary spending and areas where actual costs may be higher or lower than previous one. Adhering to a finely tuned family budget can give a much needed boost to a family’s financial future. Not having a family budget means not managing family finances. This, most often, leads to spending outside one’s means. Managing a family budget can also allow to discover ways to put money to better use, such as debt reduction or retirement savings. The most difficult part of managing a family budget is having the discipline to dedicate enough time each month to monitor it.

4.9.5 Preparation of a Family Budget

Budget is the best possible form of scaling the income, expenditure and also a way of planning the savings for future emergencies. Every family will have certain amount of disposable income out of the contributions of all earning members. The budget should include all the possible expenditure of a month. There will be multiple spending in every family like food, clothing, several bills, travel and fuel expenses, maintenance expenditure, loans or other payments, children's education, savings etc. A budget can help planning the income and expense and balance them in the best possible ways. Format of a family budget is given below.
# Monthly Family Budget format (for a daily worker)

## Monthly Family Budget Budgeted Month - January

<table>
<thead>
<tr>
<th>Income</th>
<th>Budgeted Rs</th>
<th>Actual Rs</th>
<th>Difference Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages- Husband</td>
<td>7500</td>
<td>7500</td>
<td>0</td>
</tr>
<tr>
<td>Wages -Wife</td>
<td>5000</td>
<td>5000</td>
<td>0</td>
</tr>
<tr>
<td>Wages-Other members</td>
<td>2500</td>
<td>2500</td>
<td>0</td>
</tr>
<tr>
<td>Gifts</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other incomes</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>15000</strong></td>
<td><strong>15000</strong></td>
<td><strong>0</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Budgeted Rs</th>
<th>Actual Rs</th>
<th>Difference Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food &amp; groceries</td>
<td>6000</td>
<td>6500</td>
<td>-500</td>
</tr>
<tr>
<td>Clothing</td>
<td>1000</td>
<td>850</td>
<td>+150</td>
</tr>
<tr>
<td>Electricity bill</td>
<td>200</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>Domestic fuel/ gas Charges</td>
<td>400</td>
<td>350</td>
<td>+50</td>
</tr>
<tr>
<td>Telephone charges</td>
<td>200</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>Loan Repayment</td>
<td>500</td>
<td>500</td>
<td>0</td>
</tr>
<tr>
<td>Insurance &amp;other compulsory payments</td>
<td>500</td>
<td>500</td>
<td>0</td>
</tr>
<tr>
<td>Medical Expenses</td>
<td>1000</td>
<td>500</td>
<td>+500</td>
</tr>
<tr>
<td>Gifts/ marriage expenses</td>
<td>1000</td>
<td>750</td>
<td>+250</td>
</tr>
<tr>
<td>Entertainments</td>
<td>200</td>
<td>100</td>
<td>+100</td>
</tr>
<tr>
<td>Personal expenses</td>
<td>800</td>
<td>600</td>
<td>+200</td>
</tr>
<tr>
<td>School expenses</td>
<td>1000</td>
<td>700</td>
<td>+300</td>
</tr>
<tr>
<td>Cable TV</td>
<td>150</td>
<td>150</td>
<td>0</td>
</tr>
<tr>
<td>Cosmetics &amp; personal care</td>
<td>200</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>Contingencies</td>
<td>500</td>
<td>700</td>
<td>-200</td>
</tr>
<tr>
<td>Other expenses</td>
<td>500</td>
<td>300</td>
<td>+200</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td><strong>14150</strong></td>
<td><strong>13100</strong></td>
<td><strong>1050</strong></td>
</tr>
</tbody>
</table>

**Total Savings**

( **Income- Expenses**)

<table>
<thead>
<tr>
<th></th>
<th><strong>15000</strong></th>
<th><strong>13100</strong></th>
<th><strong>1900</strong></th>
</tr>
</thead>
</table>

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4.9.6 Personal Balance Sheet

A personal balance sheet is a statement of an individual’s financial position on a given date, usually the end of a month or year. It lists the liabilities (what you owe to others in money terms) and assets (what you own in money terms. An individual can calculate his net worth by preparing a balance sheet. Net worth is the difference between assets and liabilities on any date, i.e., Net worth is assets – liabilities. Net worth shows the financial worthiness of a person.

**Table 4.2. Format of a Personal Balance Sheet of a daily worker**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Rs</th>
<th>Assets</th>
<th>Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Current or Short term liabilities:-</td>
<td></td>
<td>1. Current assets</td>
<td></td>
</tr>
<tr>
<td>a. Loan from Self Help Group</td>
<td>5,000</td>
<td>a. Cash in hand</td>
<td>1,900</td>
</tr>
<tr>
<td>b. Loan from Bank</td>
<td>10,000</td>
<td>b. Deposit with Bank</td>
<td>1,500</td>
</tr>
<tr>
<td>c. Other loans</td>
<td>2,000</td>
<td>c. Deposit with Self Help Group</td>
<td>2,000</td>
</tr>
<tr>
<td>2. Long term Liabilities</td>
<td></td>
<td>d. Deposit with Post Office</td>
<td>450</td>
</tr>
<tr>
<td>Educational loan</td>
<td>50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Investments</td>
<td></td>
<td>2. Investments</td>
<td></td>
</tr>
<tr>
<td>a. Gold</td>
<td></td>
<td>a. Gold</td>
<td>75,000</td>
</tr>
<tr>
<td>b. Fixed Deposit</td>
<td></td>
<td>b. Fixed Deposit</td>
<td>0</td>
</tr>
<tr>
<td>c. Live stock</td>
<td></td>
<td>c. Live stock</td>
<td>500</td>
</tr>
<tr>
<td>d. Others</td>
<td></td>
<td>d. Others</td>
<td>0</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>67,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Net Worth (assets- liabilities)</td>
<td>1,66,350</td>
<td>3. Land &amp; house</td>
<td>1,50,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Other assets</td>
<td>2,000</td>
</tr>
<tr>
<td>Total</td>
<td>2,33,350</td>
<td></td>
<td>2,33,350</td>
</tr>
</tbody>
</table>

4.9.7 Spending Literacy of Marginalised People

Financial management within the family is a hard nut to crack for many of the home-runners. Though the income is high, several families find they run out of financial resources and helpless at emergency situations. Proper financial
management within the family and maintaining the financial health is essential to be well supplied with economical resources when in need. It is because of the failure in managing the financial resources many families get bound to loans, and often financial distress. Improper management of wealth sources will raise possible risks and will create unwanted situations in life. Managing money is not a tough concept, if approached well and remained adhered to the budget and decisions constantly. Many people, especially marginalised, never consider or foresee the possible future expenses and drain out all the savings and resources for present day life. If reserved a bit of extra consciousness on the money matters, maintaining a healthy financial family is a possible task and this calls for spending literacy.

For poor and marginalised people, since income is limited, domestic spending should be prioritised. Use of all available cash saving devises like subsidised price shops, PDS etc for purchasing daily consumption provisions and avoiding unnecessary social and festival expenses can help them to have economical spending. A person is said to have spending literacy if he is practicing financial discipline in all his domestic spending and living within means.

4.10 Borrowing Literacy

Borrowing means “receiving something with the expressed or implied intention of returning the same or an equivalent” (Webster’s Dictionary). Borrowing money involves obligation to return the sums borrowed as per the terms and conditions expressly or impliedly stated at the time of borrowing.
Always borrowing of money or availing of credit facility is costly in the form of interest on repayment. The borrower has to pay interest on the borrowed sums as fixed by the lender at the time of borrowing along with the principal amount. People or households borrow when they are not able to meet the both ends, i.e., income and spending are unequal. Borrowing is opted when personal or household expenses exceed the money mobilized or income earned. This is true in case of individuals, institutions and even countries.

4.10.1 Borrowing Behaviour of the Marginalised People

Nowadays, borrowing is the way of life. People, either rich or poor borrow for many purposes. The credit delivery mechanisms prevailing in a country motivate or even induce people to borrow. Borrowing behaviour of the marginalised is influenced by various factors.

i. Lower disposable income

Lower disposable income available to an individual is one of the reasons of borrowing. This is true especially in the case of poor or marginalised people. The marginalised people with subsistence living find it difficult to accumulate savings or other assets or even to meet day to day domestic expenses. The pattern of income of the economically disadvantaged is often irregular or seasonal because of unemployment or underemployment. To meet the deficit, they borrow either from informal sources or from formal sources if borrowing facility is accessible.
ii. Seasonal employment

There is considerable degree of unemployment and underemployment among rural as well as urban poor. Incidence of unemployment is the highest among casual labourers. Unemployment periods are characterized by no income and to meet the personal and household expenses poor people borrow.

iii. Low asset base or unequal distribution of asset

Another major cause of borrowing by the poor is low asset base. Economic science regards households as the final consumers of goods and services and owners of all production factors. But the five year plan documents in India reveals that there has not been any major change in the structure of assets ownership in rural areas. The top 10% own over half of the total assets of a country as against the bottom 10% owing virtually nothing and the bottom 30% just owning 2% of total assets. The bulk of the assets of the poor consist of their thatched house, some household goods which have no impact on their productive or income generating capacity.

iv. Illiteracy

The literacy rate of the poor and marginalised is low compared to other categories of the society. Lack of literacy causes less or no knowledge regarding how to mobilize money, how to live within means etc.

v. Bandwagon effect

The bandwagon effect is a consequence of desire to be in style or to possess a commodity because almost everybody else has it. Bandwagon effect is so worse if the household is unable to repay the debt. Also called demonstration
effect, the bandwagon effect influences borrowing. The investment in social status consumer durable products under incomplete information results in distorted borrowing decisions leading to a debt trap.

vi. Conspicuous consumption

Luxurious consumer goods are called goods of conspicuous consumption for which the price also will be high (conspicuous price). Examples are costly mobile phones, fashionable clothing, costly jewellery, motorbikes, cars etc. Acquisition of these goods unwarranted by equivalent income to pay for it results in borrowing. If a poor person spends for these goods disproportionate to his income, it may lead to debt trap.

vii. Gambling Illusions and Alcoholism

Addiction to gambling and alcoholism causes marginalised household members to borrow. The ratio of cost of alcoholism to net daily income of the poor and marginalised is becoming significantly high. The earning member in a poor family may sometimes use substantial part of income to buy lottery tickets and alcohol.

viii. Dependency ratio

The number of dependents in a family (or non income earners) is another important factor that determines the borrowing behaviour of poor households. Households with more non-earner dependants in the family result in an increase in household expenditure lowering their savings and the deficit they borrow usually from informal sources.
ix. Hospitalisation expenses

Persistent illness may cause the households to save less and to meet the deficit they are forced to borrow. Sometimes the income or savings of the household may not be enough to cover the total cost of hospitalisation or cost of funeral. The position of the household will be worse if the deceased was a bread earner of the family.

x. Cost of higher education

Higher education is becoming costly nowadays. Banks are providing educational loans to people to pursue higher studies. Often these loans are unsecured loans and poor people have more access to it.

4.10.2 Sources of Borrowing

i. Banks

Commercial bank is one of important sources of borrowings for all categories of people. The banking system in India in the last four decades has shifted from urban oriented lending to rural oriented lending, a paradigm shift popularly called class banking to mass banking or social banking. Now banks are playing a key role in the socio economic reconstruction of India. Banks have various schemes of credit to the economically marginalised people on the principles of Financial Inclusion. These schemes are as per Governmental welfare measures. Borrowing schemes of commercial banks are characterised by lower rate of interest and easy repayment schemes.
The internal group to examine issues relating to rural credit and microfinance identified the following supply and demand perspectives that lead to a wide gap in the availability of financial services to the marginalised sections.

**Supply side:-**

a) Persons are unbankable in the evaluation or perception of bankers.

b) The loan amount is too small to invite the attention of bankers.

c) The person is unbankable on a credit appraisal approach but distances are too long for servicing and supporting the accounts and expanding branch network is not feasible and viable.

d) High transaction cost in dealing with large number of small accounts.

e) Lack of collateral security.

f) Inability to evaluate and monitor cash flows and repayment capacities due to information asymmetry and lack of data and absence of credit history of people with small means.

g) Human resources related constraints both in terms of inadequacy of manpower and lack of proper orientation or exposure

h) Lack of banking habit and credit culture.

**Demand side:-**

From the demand side, there are several reasons for the rural people remaining excluded from the formal banking sector such as:-

1) High transaction costs at the client level due to expenses such as travel costs, wage losses, incidental expenses etc

2) Documentations
3) Lack of awareness
4) Lack of social capital
5) Non-availability of ideal products
6) Very small size of transactions which are not encouraged by formal banking institutions.
7) Hazards related to documentation and procedures in the formal system.
8) Services from money lenders/informal sources and
9) Prior experience of rejection.

ii. Co-operative Societies

Co-operative Societies are one of the major sources of borrowings in the formal sector in rural areas. In Primary Agricultural Credit Societies, loans are given for short periods at lower interest rates. The government seeks to achieve this through broadening the membership base of weaker sections of the society and ensuring flow of finance to them.

iii. Self Help Groups

In the state of Kerala, through concerted community action under the leadership of local self governments, Kudumbashree today is one of the largest women empowering projects in the country. The programme has 37 lakh members and covers more than 50% of the households in Kerala. Built around three critical components, micro credit, entrepreneurship and empowerment, the Kudumbashree initiatives have today succeeded in addressing the basic needs of less privileged women in Kerala, thus providing them a direction to life and better financial future. Kudumbashree plays active role in enhancing the
financial state of less privileged women in the state through its thrift and credit societies. These societies facilitate them to save and provide them with cost effective and easy credit. The savings of the women are pooled together and given out as loans.

iv. Other sources

Other sources are local money lenders, friends and relatives etc. Despite the spread of banking in the modern context, changes in the financial sector and the rising awareness about the credit delivery system among rural households, the number of moneylenders and the quantum of money lent by them have registered a substantial jump in the last decade. The dependence on moneylenders has not decreased and it has, on the other hand, increased in several rural regions (Reserve Bank of India 2005)\(^7\). Reports from the 11 regional offices of the RBI show that the number of registered moneylenders increased from 12,601 to 19,627 between 1995 and 2006. Anecdotal evidence suggests a corresponding rise in the unregistered moneylenders. Their mode of operations such as maintaining inter-personal relationship with the borrowers, informal approach, round the clock availability of finance, made them important lenders in the villages. Their borrower-friendly approach strengthened their position. These informal credit providers gave loans against security of gold jewellery, land documents, cultivation rights, Promissory Note and even against utensils.
4.10.3 Factors Which Restrict the Access of Poor People to Formal Institutional Credit

Various studies reveal several factors which have restricted the access of the rural poor to formal institutional credit. Some of these are:

(A) From the angle of the poor

1. Due to their social, economic and educational backwardness and being unorganised they are unaware of various programmes of and facilities available from the Government and banks and are generally deprived of access to such benefits.

2. They have an apprehension that the banks are not meant for poor people like them and they would not be able to get loans from the banks.

3. Lack of security to avail bank loan.

4. Documentation procedures, rigid lending policies and norms of the banks generally make the poor ineligible for bank credit.

5. Funds requirement for consumption, social and even production purposes, though small, are generally immediate. The uncertainty and long delays in obtaining such loans from the banks discourage them to approach the banks.

6. In some cases, past unpleasant experience of the poor with the banks and government agencies is also a discouraging factor.

(B) From the angle of banks

1. General mental reservation about financing such poor borrowers mainly due to the fear of bad debts.

2. Lack of security to back such loans.
3. Non-compliance of documentation and other formalities by the borrowers.
4. Non-conformity with the usual banking norms.
5. Low returns to the bank on account of lower rate of interest to be charged on such small loans in accordance with the regulations of the central bank/government.
6. Servicing large number of small loans with frequent transactions spread over a vast area is unwieldy besides involving high cost, making it inconvenient and apparently uneconomic for the banks. One would not be surprised if in the name of the market orientation and total freedom to lend, such small poor borrowers are the likely casualty and left high and dry.

4.11 Investment Literacy

Investment in a broader sense means putting money into something with the expectation of gain that upon thorough analysis has a high degree of security for the principal amount, as well as security of return, within an expected period of time. Investment is related to saving or deferring consumption. The surplus money with an individual may be deposited in a bank or in some other areas depending on the perception of the investor. Whatever decision is made, investment means a sacrifice in the present in the hope of deriving benefits in the future. Every investment decision has two key aspects: time and risk. While the sacrifice occurs in the present and is certain, the benefits come in the future and may be uncertain. Economic well being of a person in the long run depends significantly on how wisely investment decision is made.
4.11.1 Common Investment Avenues

An investor is confronted with many investment avenues. They are:-

i. Equity shares or stocks – Equity shares represent direct ownership securities in companies. Equity shares are classified into the following:-

• Blue Chip Shares
• Growth shares
• Income shares
• Cyclical shares
• Speculative shares.

ii. Fixed income securities: Fixed income securities offer fixed stream of returns. The important fixed income securities in India are:

• Preference shares
• Debentures or Bonds of Companies
• Indira Vikas Pathra
• National Saving Certificates
• Government Securities
• Money market Instruments

iii. Deposits – Deposits, like fixed income securities, earn a fixed return. But deposits are not transferable. The important types of deposits in India are:

• Fixed Deposits in Banks
• Post Office Deposits
• Fixed Deposits with NBFCs
iv. Tax Sheltered Saving schemes – These schemes provide tax benefits to those who contribute to them. The most important Tax sheltered saving schemes in India are:

- Provident Fund Scheme
- Public Provident Scheme
- National Saving Scheme

v. Mutual Fund Schemes – Mutual Fund schemes help an investor to buy indirectly equity shares or fixed income instruments by buying the units of various schemes floated by Mutual Funds. There are two broad categories of mutual fund schemes – Debt oriented schemes and equity oriented schemes.

vi. Real assets – All the aforesaid investments are monetary assets or financial claims. Real assets are physical properties that are not denominated in rupees. The important categories of real assets are

- Land and buildings
- Precious metals
- Precious stones
- Art objects amount

vii. Life Insurance – Life insurance can be regarded as an investment in the sense that premium is the sacrifice and the assured amount is the benefit. The important types of life insurance policies are:

- Whole life Policy
- Endowment Policy
4.11.2 Investment Attributes

A potential investor has to evaluate investment avenues before taking an investment decision. For evaluation, following attributes are important:

i. Rate of return - Rate of return is the annual yield from the investment which can be calculated by using formula.

ii. Risk - Risk is extend of variations in the rate of return.

iii. Marketability - An investment is highly marketable if it can be transacted quickly at low cost without price loss

iv. Tax benefits - Taxes are statutory payments made by an investor out of the income from investments. Tax benefits are important considerations before selecting an investment.

v. Convenience - Convenience broadly refers to the ease with which an investment can be made and looked after.

4.11.3 Investment Behaviour of Marginalised People

The poor people have very low seasonal income which restricts them from investing in high profile financial assets or real assets. The researcher observed that the poor save money in Self help groups and a few people in Banks and often these small saving can be considered as their investments. Majority of them invest in kind by purchasing gold with the money saved. The poor or marginalised people are spending for the education of their children as education expense is not a mere expense but it can be considered as an investment. Keralites know well the meaning of famous quotation of Benjamin Franklin “an investment in knowledge always pays the best interest”. Kerala is
the single largest originator of education loans for the country as a whole till date. Total disbursal of education loans amount to Rs 6,000 Crore. (Business Line, 2011)\textsuperscript{79}.

\textbf{4.12 Measurement of Financial Literacy of Marginalised People}

“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 Survey, 2011)\textsuperscript{80}.

The need and importance of financial literacy can be well documented but measuring financial literacy of an individual is a complex process. Financial literacy is defined as the ability to take financial decisions. General literacy is measured by taking two factors namely, ability to write and ability to read ones name. If a person is able to write and read his/her name he/she is considered a literate person. But financial literacy is quite broad in dimensions than general literacy. The concept of financial literacy centres on financial behaviour or financial action. Financial knowledge leads to financial action.

\textbf{Financial literacy = Financial knowledge + Financial Action}

Knowledge leads to behaviour or action. Better financial knowledge leads to better financial action. Financial actions are reflected by participation in formal financial facilities rather than informal financial facilities or no participation at all. Financial literacy measures whether the economically marginalised people take financial action by using formal or semiformal mechanisms for savings, spending, borrowing and investment. Lusardi and
Mitchell (2007) showed that actual financial knowledge influences financial behaviour.

The use of formal financial products and services available in a country by an individual is an indicator of financial behaviour which exhibits financial literacy. The people have access either limited or unlimited to various kinds of financial services and products offered by formal, semi formal and informal financial service providers. In India, the Central Government at the State Governments have many schemes to the weaker sections of the society under various schemes for their social and financial development. Awareness and use of these schemes indicate the presence of financial literacy among the beneficiaries. Similarly there are formal as well as informal avenues for saving, spending, borrowing and investing money, whether economically marginalized people of Kerala have knowledge about these formal sources and whether they are using these facilities are taken to measure financial literacy.

There are a very few studies which look at levels of financial literacy in developing countries, especially in India. Attempts were made by many agencies to the present the importance of financial literacy theoretically. In the context of financial inclusion, the scope of financial literacy is relatively broader and it acquires greater significance since it could be an important factor in the very access of such excluded groups to finance. The focus of financial literacy of the marginalised is primarily on the individual who usually has limited resources and skills to appreciate the complication of financial dealings with financial intermediaries on matters relating to personal finance on a day to day basis.
Measuring personal financial literacy, especially of poor and economically marginalised people, should cover all the elements of financial literacy. Financial literacy is the ability to know, monitor and effectively use financial resources to enhance the well being and economic security of oneself, one’s family and one’s business. For the purpose of the study entitled “Financial literacy of the economically marginalised people in Kerala”, financial literacy is measured by considering the knowledge to take effective actions in saving, spending, borrowing and investment.

Financial knowledge means understanding or awareness of individuals to take effective decisions regarding finance. General awareness about financial products and services, knowledge about legitimate sources of earning money other than normal occupation or profession, means of saving money, spending pattern and investment avenues are various dimensions of financial knowledge. The financial knowledge is acquired through various sources, namely, experience, education and environment. An individual may learn from his own experience or from the experience of his friends and relatives that earning, spending and investing the hard earned money wisely is necessary for his financial well being and well being the family. This knowledge can also be imparted to the people by deliberate interventions of the formal or semi formal financial intermediaries, namely, Government, local bodies, commercial banks, self help groups etc. This knowledge is also related to the general literacy level of the individuals and attitude towards money related matters. Mere knowledge of money related matters need not contribute to higher level of financial literacy.
Financial knowledge leads to financial action. Financial action means deliberate effort to mobilize money, budgeted spending, calculated savings and investment to meet specific needs in formal or semi formal avenues. Financial action results in positive financial behaviour. The individual firmly believes that positive financial actions leads to personal well being which ultimately avoids financial distress which is the end result of financial literacy.

4.13 Measurement of Financial Literacy in Selected Countries

Financial literacy is typically an input to model the need for financial education. Defining and appropriately measuring financial literacy is essential to understand educational impact as well as barriers to effective financial choice. The broad range of financial literacy measures used in research over the last decade is briefly explained. The terms financial literacy, financial knowledge and financial education often are used interchangeably in the literature and popular media. Few scholars have attempted to define or differentiate these terms. There are no standardized instruments to measure financial literacy.


In Australia, Financial literacy is about understanding money and finances and being able to confidently apply that knowledge to make effective decisions. The National Financial Literacy Strategy was developed to provide a national direction for this priority area. Till now Four National Financial Literacy Surveys were conducted by Australia. ANZ Surveys are part of Australia’s long-term commitment to improving the financial inclusion and well-
being of vulnerable, low financial literacy individuals and communities. In all the four surveys, after having identified the behaviours that indicate a person’s financial literacy, the next step was to examine which groups performed well in terms of these behaviours and which groups did not. In other words, which groups display behaviours that indicate high levels of financial literacy and which display behaviours that indicate lower levels of financial literacy? Then, to help explain differing levels of financial literacy between groups, associations with peoples’ characteristics such as age, education household circumstances, financial knowledge, numeracy and financial attitudes were examined. The survey involved three stages:

Stage 1- Developing a framework for measuring financial literacy;
Stage 2 -A telephone survey of a fixed number of adult Australians, comprising 145 finance and 25 demographic questions; and
Stage 3- an in-depth survey of 202 people including a self-completion component and in-depth interview of 1–1.5 hours each.

2. Financial Literacy Measurements in Singapore

The first National financial literacy survey in Singapore was conducted in March 2005. The survey covered 2023 Singaporeans between 18 and 60 years of age by the Money SENSE Financial Steering Committee which was formed in 2003. In measuring financial literacy, 3 areas were covered, namely, Basic Money Management, financial planning and investment know how. In computing an aggregate financial literacy score, each question in the survey assessing the actions and knowledge was given a weighted score and the scores
for all the responses were then aggregated and normalized across 0-100 scale to derive a financial literacy score for the Singapore population (The Money SENSE, 2005).  

3. Financial literacy Measurement in India

i. Survey by Shawn Cole (2009)

Shawn Cole published a working paper on ‘financial literacy, financial decisions and the demand for financial services, evidence from India and Indonesia’. They conducted a survey in March and April of 2006. The survey covered 15 households in each of 100 villages, located in three districts of India around Ahmadabad, and focused primarily on poor and subsistence agricultural labourers. The survey measured financial literacy in a manner consistent with methodology that has been used in the United States by adapting three questions used by Lusardi and Mitchell (2006) and they added one more question. In addition to financial literacy, the survey also captured other household characteristics which are important determinants of financial behaviour. Cognitive ability was also measured with eight mathematical questions (Shawn Cole 2009).


National Council of Applied Economic Research, (NCAER) and Max New York Life Inc. conducted a survey in 2008 – ‘How India earns – spends and saves’ among rural and urban poor to gain deeper insights into the motives for financial savings, the degree of financial security of Indian households and
the degree of sophistication that households bring to bear on their savings and investment decisions.

4.14 Design of the Interview Schedule

For collecting data to measure financial literacy, a detailed interview schedule was designed with a view to capture financial flows of respondents. The first part of the schedule constituted of 20 base questions to assess the socio-economic profile. The second part of the schedule consisted of questions of financial actions over the four tiers of financial literacy, namely, saving, spending, borrowing and investment.


<table>
<thead>
<tr>
<th>Core concepts</th>
<th>Knowledge</th>
<th>Action\Behaviour</th>
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| 1. Income     | • Income mobilisation is the base to financial wellbeing  
• Education enhances earning power  
• Explore various legitimate sources of income | • Understand your income  
• Learn about taxes and any workplace benefits |
| 2. Saving     | • Saving is the base of financial well being  
• Learn how money grows  
• Learn about approved formal avenues for saving money | • Set financial goals  
• Open a savings account in a Bank and deal in it  
• Save for retirement, education, and other needs  
• Save for short-term and long-term goals Track savings/ investments and monitor what you own |
| 3. Spending   | • Identify how to prioritise spending choices given available resources  
• Understand long-term versus short-term implications of spending | • Track spending habits  
• Develop a spending plan (budget)  
• Live within your means  
• Compare shop  
• Understand the effects of spending decisions on yourself and others |
### 4. Borrowing
- If you borrow now, you pay back more later
- The cost of borrowing is based on how risky the lender thinks you are (credit score)
- Understand when and how to use credit effectively
- Plan, understand, and shop around for a loan with the lowest rate and best terms for you
- Plan and meet your payment obligations
- Track borrowing habits

### 5. Investing
- Know how to meet financial goals and build assets
- Balance risk, return, and liquidity when making investment choices
- Invest for short-term and long-term goals
- Track investments and monitor what you own

### 6. Protecting
- How to manage risks from potential losses or unexpected events
- If it sounds too good to be true, it probably is fraud
- Choose appropriate insurance
- Build up an emergency fund
- Consult a qualified/appropriate professional for help when needed
- Avoid practices that are not in your financial best-interest
- Critically analyse and evaluate advertisements and offers before acting
- Avoid fraud and scams

### 4.16 Conclusion

The theoretical overview presented here points out the importance of financial literacy especially of the marginalised group. Financial literacy benefits all sections of the society. The ripple effects of financial education go far beyond the individuals concerned, with benefits also for the wider society. It can help address problems of financial exclusion: it can encourage citizens, even those on low incomes, to plan and save some part of their income. Financially educated citizens, able to seek out better, cheaper and more appropriate products and services, can drive efficiencies in the financial industry and improve economic welfare by fostering increased competition, spurring innovation and demanding
improvements in quality and diversity. Financially literate consumers can be, through their representative associations, a more efficient interlocutor in the process of outlining future public planning of expenditure, investment, and regulation.
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