Chapter-1 Introduction

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In the classical theories, saving by household has been considered as one of the important determinants of economic growth. This household savings are considered as an important source of investment to be made by the firms for the production purpose.

In the Indian economy, the household sector contributes the considerable share in the total savings. In the household sector, households have tremendous saving potential which has not been considered seriously by the policy makers and hence, measures have not been chartered to mobilize these huge savings. By increasing adequate financial literacy among Indian households, the problems of decline in saving and investment rated can be overcome by financial institutions and policy makers. Because financial literacy/education is important to both the security of individuals and the security of nations

1.2 Literacy - Its Types:

Literacy is of various types and sub-types eg. Functional literacy (is required to get along successfully on a day-to-day basis), Cultural

Literacy (is about customs, values, and beliefs of one's own culture and the cultures of others), Information Literacy (is related to identifying, locating, evaluating and effectively using information for the issue or problem), Media Literacy (about critical understanding of the mass media), Computer Literacy (the ability to use a computer and its software to accomplish practical tasks), Mathematical Literacy (is a mastery of the basic symbols and processes of arithmetic), Technology Literacy is about the ability to use new media such as the Internet, to access and communicate information effectively), Global Literacy (Understanding the interdependence among people and nations and having the ability to interact and collaborate successfully across cultures) and so on.

1.3 Concept of Financial Literacy:

Financial literacy is considered in the context of economic inequality. Some of the forms of financial inequality are- paying lower wages to women for the equal work compared to males, denial of certain jobs and promotions, incentives etc. Thus, financial literacy in short, refers to:

1. The ability to understand how money works and why it is important?

2. How someone manages to earn or make money and how that is managed or how person invests it to turn it into more?

3. It also refers to the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources.

1.4 Definition of Financial Literacy:

A number of definitions of financial literacy exist in the literature. In gist, these definitions can be summarised as follows-

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

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

Following are some definitions used by research scholars in selected studies.

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

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

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

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

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

vi. "Financial literacy refers to a person's ability to understand and make use of financial concepts" (Lisa et. al 2008).

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

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

ix. “Confidence with managing money” (ASIC, 2003).

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

xi “The ability of people to make informed judgments and take effective decisions in managing their finances” (MAS, 2005).

A thorough analysis reveals that all definitions convey the same meaning and attempt to define financial literacy as a state of understanding about finance.

This understanding equips a person with the knowledge and skills needed to realise financial security of himself and his family and thus survive and achieve lifetime well-being. The definitions of financial literacy also refer to broad outcomes and explain that financial literacy provides lifetime financial security and well-being, the ability to respond competently to life events to survive in a modern society. The common thread of financial literacy is positive financial outcomes resulting from proficient competence in key financial activities and concepts.

1.6 Components of Financial Literacy

Financial literacy has three distinct but dependant components:

(i) Core competency

(ii) Proficiency and

(iii) Opportunity

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

1.6.1 Core Competencies

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

i. Numerical ability

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

iii. Saving

iv. Borrowing, and

v. Investment

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

(i) Numerical Ability

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

(ii) Budgeting and Living Within Means

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

(iii) Savings

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

(iv) Borrowing

In modern era, borrowing is a way of life for all categories of people. Many people take up loans or mortgages. An indicator of competent borrowing is that loan amount should be relative to earnings. A large proportion of respondents in various financial literacy surveys did not understand the difference between an unsecured or secured personal loan, and fixed or variable interest rate. Debt literacy determines proficient borrowing. The core competency of a financially literate person is the ability to understand debt, and the processes involved to avoid it, reduce it and repay it. It also relates to competence in using loans

(Lusardi and Tufano, 2009) and responses to debt including the ability to determine whether debt is justified (World Bank, 2008).

Debt illiteracy is therefore related with over- indebtedness, and an inability to reduce existing levels of debt (Lusardi and Tufano , 2009).

(v) Investing

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

1.6.2 Proficiency

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

Financial knowledge

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

1.6.3 Opportunity: Application of knowledge

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

Skill and confidence

A financially capable person possesses all the skills necessary to effectively manage finances to achieve well being, and this includes communication skills, interpersonal skills, reading skills, mathematical and computational skills etc. The definition of financial literacy adopted in the

United States by the Jumpstart coalition is “the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial wellbeing” The element of confidence is added to the Canadian definition of financial literacy also together with skills. “Financial literacy means having the knowledge, skills and confidence to make responsible financial decisions” (Sandra Huston, 2010). Remund in his search for a better definition to financial literacy states: “based upon a review of research studies since 2000, the many conceptual definitions of financial literacy fall into five categories: (1) knowledge of financial concepts, (2) ability to communicate about financial concepts, (3) aptitude in managing personal finances, (4) skill in making appropriate financial decisions and (5) confidence in planning effectively for future financial needs” (Remund, 2010). Financial literacy therefore requires communication skills also. It includes the ability to apply knowledge and to communicate that knowledge, making financial literacy vital to effective decision making.

Attitude and Motivation

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

1.7 Importance of the Financial Literacy:

The importance of the financial literacy can be understood by 1. the impact of the financial literacy to different segments of the population and 2. Area covered under the financial awareness.

1.7.1 Importance of Financial Literate to different segment of population

Financial literacy is essential for both developed nations and emerging economies. However, we need to bear in mind that the focus of financial literacy initiatives would vary depending on the economic profile of the target population. For developed countries, the access to financial products/ services is fairly widespread and hence, consumers/ market participants are required to be educated more about the characteristics of the financial products/services, including their risks and returns.

All Groups of People:

Everyone associated with the financial system needs to be financially literate. This includes all users of financial services, be it the financially excluded resource-poor, the lower and middle income groups or the high net worth individuals; the providers of services; and even the policy makers and the regulators.

Resource Poor Population:

The resource-poor population, which operates at the margin, vulnerability can be acute due to constant financial pressures.

Household cash management can be daunting under difficult circumstances, with few resources to fall back upon. Financial literacy efforts, in case of such population groups, essentially, involves educating them about the benefits of being part of the formal financial system and managing short term volatility in incomes and meeting unexpected emergencies without getting trapped in unnecessary debt. To cite one example, a study by NCAER and Max New York Life has shown that in India, around 60 per cent of labourers surveyed stored cash at home, while borrowing from moneylenders at high interest rates; a pattern of saving money that is bound to aggravate financial vulnerability of these labourers.

The process of educating these excluded sections would involve addressing deep entrenched behavioural and psychological factors that are major barriers to participating in the financial system.

Middle and lower-middle income groups:

These groups that are participating in financial markets as either savers or borrowers or both, i.e. the financially included, financial literacy efforts should aim at enhancing their knowledge about the market and new products/services. For instance, there is a large section of our population that has a bank account but refrains from participating in the capital market on account of lack of knowledge. Financial literacy, in such cases, would focus on creating awareness about the way the capital market functions and also about the fact that the equity market provides relatively higher returns as compared to other investments, over a longer time horizon.

High Net worth Individuals:

For these people, better knowledge about the financial markets, new and innovative products and instruments is important as it helps them in making better use of the available avenues in the financial markets. This knowledge is also useful for fetching greater returns from their investments in the market and to avail credit at relatively cheaper rates. However, whether saving or investing, the basic lesson that "higher return implies higher risks" should not be lost sight of.

Banks and Financial Institutions:

The need for financial literacy for the users of financial products/ services is a well-accepted fact, it is emphasized that even banks, financial institutions and other market players need to be financially literate and be fully aware of the risk and return framework.

Financial literacy for the providers of financial services would involve understanding the risks involved in their businesses and in the products that they offer to their customers. As market players, they need to understand risks inherent in complex financial products and choose wisely while committing funds. For service providers, financial literacy also involves understanding the needs of existing and potential customers and creating products and services suited to those needs.

Opinion Makers and Policy Makers:

Financial literacy is also relevant for opinion makers and policy makers. Literacy is a must to gauge the needs of the population and financial institutions; to understand the risks inherent in products and markets; and to create a policy environment conducive to attainment of the national goals. Only such an approach would ensure that physical and financial resources are put to their optimum use to generate higher economic growth, while minimizing the financial stability risks.

1.7.2 Importance of the Study as per Area covered under the financial awareness

Indian households make many financial decisions each year. These relate to a wide range of financial matters, including decisions on how to budget, how much to spend and to save, where to invest their money i.e., their earnings, how to manage their financial risks, how much debt they may need to fund their expenditure, and what form that debt should take. These decisions range in complexity, but all require at least a basic level of financial literacy.

In the world of escalating financial complexity, there is an increasing need for financial knowledge and at least basic financial skills. Technological advances have dramatically transformed the provision of financial services in India and around the world. There is an ever increasing diversity of financial products and services, including debt products and investment opportunities available to the public. While this provides increased benefits, it also entails more complex risks, including risks that are not always readily apparent to the unwary. Accordingly, the scope and complexity of the financial decisions an individual has to make in managing their financial affairs has grown significantly. Individuals must be able to differentiate between a wide range of financial products and services, and providers of those products and services. Based on the empirical justification drawn above, conduct of this study is deemed to be rational in nature.

The financial literacy helps in creating awareness about the following areas:

Financial Market performance:

The financial literacy helps in understanding the ups and downs in the financial markets, changes in rates and policies related to financial markets, reasons behind such changes and its implications of an individual and on the entire economy as a whole, changing in trends in global markets and its impact, prediction of the market movement and gain or loss occurring thereof and so on.

Financial Management and Decision making:

The financial literacy helps in financial management for individuals, government and corporate world. Multiple decisions about savings and its instruments, investment avenues, changing the portfolio as per the changes in policies, ups and downs in the market, allocation of the assets as per risks involved, calculation of different types of risks and uncertainties, risk taking capacities etc. This all helps in decision making in financial matters.

Knowledge of various Savings and Investment instruments:

The financial literacy creates awareness about the various savings and investment instruments like- Fixed Deposits, Recurring Deposits, Public Provident Fund, National Saving Certificates, Post Office Savings, Mutual Funds, Life Insurance, Debentures, Bonds, Share Market, Commodity Market, Forex Market, Real Estates, Gold/Silver, Chit Funds etc. for better returns and risk management.

Knowledge of various Debt instruments:

Management of debt also requires a good amount of financial literacy regarding prevailing rates and instruments for different purposes like- Housing Loan, Vehicle loan, Education Loan, Personal Loan etc.

Awareness about Financial Scams:

Now a day variety of financial scams and frauds are taking place. Individuals, Government Departments, Banks and Financial institutions as well as big corporate houses are prone to such scams of kind like Banking Frauds, Share Market Frauds, Chit Fund Frauds, Corporate Frauds, Consumer Court Decisions, Misuse of Internet Banking, Misuse of Credit/Debit Cards, Signature Forgery, Corruption/Bribing officers etc. Thus, the literacy related to types of scam, preventive measures, role of vigilance department etc. is required.

1.8 Conclusion:

To conclude, Financial literacy is the ability to understand how money works in the world: how someone manages to earn or make it, how that person manages it, how he/she invests it (turn it into more) and how that person donates it to help others. More specifically, it refers to the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources. The financial literacy affects wide segment of the population including businessman, house wife, stock market people, bankers, industrialists, government and corporate.