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Financial Literacy: Important for Growth and Inclusion

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Abstract:

The financial system plays an important role in the growth and development of a nation. The basic function involve is to transfer fund from surplus generating unit to deficient generating unit. Since economic reforms, India has one of the highest saving rates in the world but allocation of these savings is a cause for concern. Creating financial literacy plays an important role in information, knowledge, skills to evaluate options and enables consumers to understand the implications of alternative financial decisions. Though financial literacy increased in India but negative symptoms which are observed are underinsurance, debt trap, insufficient retirement fund, low return on investment and the cause of all these is one and the same is financial Literacy. This research paper with the help of questionnaire outlines the necessity and importance of financial literacy for the growth and inclusion.

Key words: Financial literacy, investors, financial markets and financial innovations

1. Introduction

The financial system plays an important role in the growth and development of a nation.. Financial system comprises a set of sub-systems of financial institutions, financial markets, financial instruments and services which help in the formation of capital. Thus, a financial system provides a mechanism by which savings are transformed into investments and it can be said that financial system play an significant role in economic growth of the country by mobilizing surplus funds and utilizing them effectively for productive purpose.

Financial literacy can be considered to be pillar for the efficient and effective functioning of the financial system. Financial literacy is nothing but knowledge about finance. In a simple term, financial literacy is an understanding of the most basic economic concepts needed to make a choice of alternatives and take informed decisions. A number of definitions of financial literacy exist in the literature. Some of this are-

- Noctor, Stoney and Stradling (1992), defined the term, financial literacy as “the ability to make informed judgments and to take effective decisions regarding the use and management of money”
- Anthes (2004) stated that “personal financial literacy is the ability to read, analyze, manage and communicate about the personal financial conditions that affect material well being”.
- OECD (2005), defines 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 confidence 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.”

2. The Importance of Financial Literacy

Financial literacy is important because it benefits consumers, the financial system and the economy. Financial literacy causes consumers to behave in a particular way, and develop particular attitudes concerning money. Financial literacy enables people to make better financial decisions, to appreciate their rights and responsibilities as consumers of financial products, and to understand and manage risk. Thus, personal financial literacy ensures and prepares an individual to manage money, credit, and debt effectively. Better informed consumers make more effective choices and more appropriate decisions. They are less likely to be mis-sold or mis-buy products and services.

The benefits of financial literacy to the household will also bring benefits to the economy and the financial system which are as follows:

2.1. Benefits to Consumer

- Increased saving and retirement planning
- More realistic assessments of financial knowledge by consumers
- Investing and choosing the right financial products with confidence
- Consumer rights and regulatory intervention
- Financial efficiency in the form activity in financial market and debt management

2.2. Benefits to Financial System

- 1 Greater competition, innovation and quality products
- 2. Disciplined and broader financial market.
- 3. Less social security burden.

2.3. Benefits to Community

- 1 Financial inclusion
- 2 Understanding government financial policies

3. Consequences of Financial Illiteracy

Financial illiteracy or low of financial literacy is resulted in the lack of healthy financial ways of thinking, lack of necessary financial knowledge and difficulties in applying financial knowledge. Financially illiterate individual either voluntarily do financial exclusion or will get the financial information from unreliable sources, the analysis of which may be resultant into the misallocation of private wealth can cause social decline and increase public expenditure in the form of social security. Absence of this knowledge and skill pose a variety of risk to individual, societal and economy as a whole as shown below.

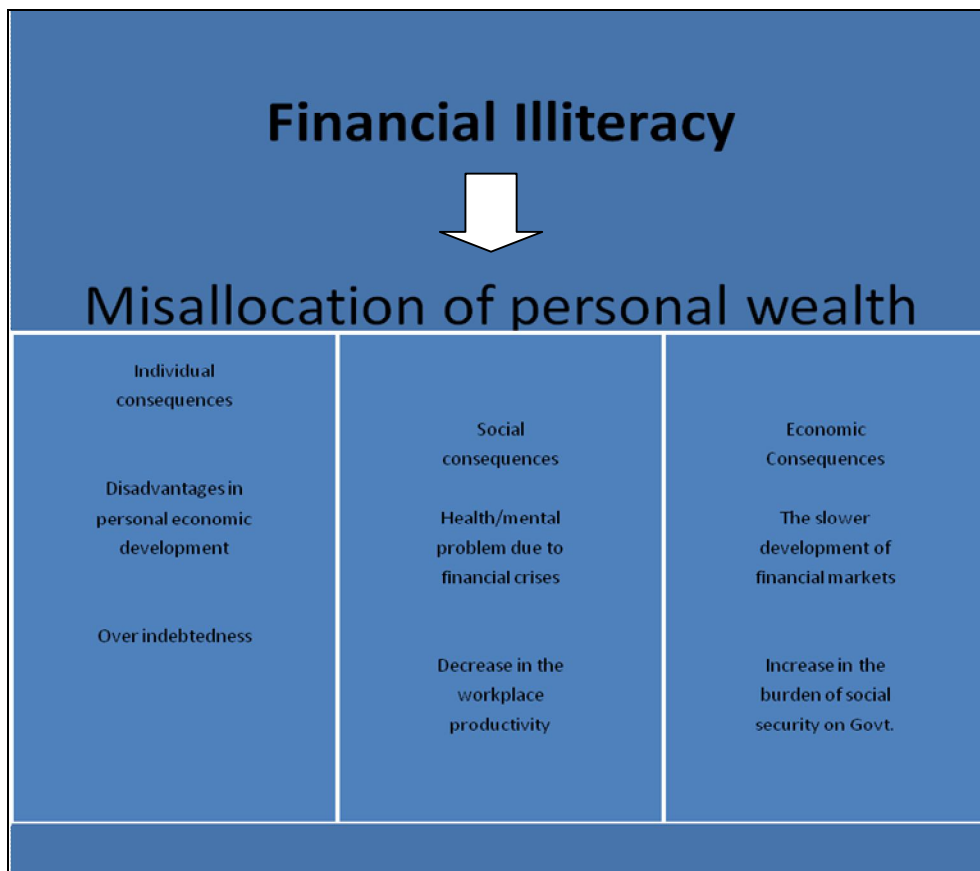


Figure 1

4. Results

4.1. Here are some of the results which arrived from the Questionnaire

- Only a minority keep close track of expenses
- Budgeting is mainly just for big items.
- In most cases financial situation fluctuates between in and out of control.
- Most respondent are of view that it is extremely important for them in today's environment to be aware about how to manage money and to take care of finances.
- More get financial education at home and friends than school.
- Not making proper plan for achieving financial goal.
- Despite a lack of fiscal discipline in some areas, a large majority of the respondent discuss before major purchases.
- Most interested in attending seminar to enhance their financial literacy.

4.2. The suboptimal consumer behavior identified in the financial literacy surveys include

- Not planning ahead, specifically for retirement;
- Lack of confidence;
- Choosing inappropriate financial products;
- Not assessing the appropriateness of already owned products;
- Not considering fees and charges;
- Not choosing credit card and saving account on the basis of interest rate.
- Not considering inflation and taxes for calculating real rate of return.
- Ignoring investment objectives;
- Not receiving or seeking independent advice;
- Relying too heavily on non-professional sources of information;
- Incurring unnecessary fees, such as credit card fees for late repayments;
- Not gathering or reviewing information;
- Not buying insurance when needed.
- Risk and return is only considered by some of respondents
- Do not check credit card statements;
- Are of view lowest Interest rate is the best loan
- Short sightedness prevent from long term wealth creation

4.3. Some of the financial concept like diversification, compound interest, time value of money, inflation should be more elaborated and emphasized.

4.4. Some of the financial products like online banking, online broking, mediclaim policy, pension plans, and credit cards should be more elaborated and emphasized.

4.5. Most of the respondent also likes to know where and how to make complaints/resolve disputes where they are not satisfied by particular product and services.

5. Conclusion

The above result outlines the necessity and importance of financial literacy for the growth and inclusion. Better informed consumers make more effective choices and more appropriate decisions whereas financially illiterate individual either voluntarily do financial exclusion or will get the financial information from unreliable sources, the analysis of which may be resultant into the misallocation of his wealth which also can cause social decline and increase public expenditure. The benefits of financial literacy to household will also bring benefits to the economy and the financial system.

6. Questionnaire on Financial Literacy

SL. No.	Character	Response %
1.	Gender	
	Male	80
	Female	20
2.	Age in Years	
	Below 25	13
	25 To 40	36
	40 To 60	35
	60 and above	16
3.	Education	
	Under Graduates	14
	Graduates	25
	Post Graduates	35
	Professionals	26
4.	Income per Month (in Rs.)	
	Less than 10,000	8
	10,000 To 25,000	18
	25,000 To 40,000	49
	40,000 and above	25
5.	Employment Status	
	Employed	38
	Self employed	41
	Retired	21

Table 1: Profile of the Retail Investor

SL. No.	Character	Response %
1.	Who is responsible for day-to-day decisions about money in your household?	
	• You	41
	• You & Your Partner	39
	• Your Partner	15
	• Another family member or (or family members)	05
2.	Does your household have a budget?	
	• Yes	35
	• No	65
3.	Thinking about budgeting, please indicate which of the following statements best describes you:	
	• I always budget my money	20
	• I budget for bigger ticket items like events, vacations, gifts etc.	51
	• I don't budget my money	29
4.	Which one of the following best describe the extent to which you control your regular household/personal expenses	
	• I don't keep an eye on expenses at all	20
	• I keep my eye on expenses a bit	50
	• I use written records to keep a close eye on expenses	25
	• Can't say.	5

5.	<p>Extent to which current financial situation is felt to be under control</p> <ul style="list-style-type: none"> • Out of control all of the time • Out of control most of the time. • Fluctuates between being in and out of control • Can't say 	<p style="text-align: right;">10 20 65 5</p>																																							
6.	<p>If you have questions or are looking for information on money management and financial planning, where do you turn?</p> <ul style="list-style-type: none"> • My parents • My brothers or sisters • A teacher • Friends • The internet • A Bank/Other Financial Institution 	<p style="text-align: right;">15 20 5 15 30 15</p>																																							
7.	<p>Thinking about your life today, how important is it for you to be aware of how to manage money and know how to take care of finances?</p> <ul style="list-style-type: none"> • Not at all important • Somewhat unimportant • Neither important nor unimportant • Somewhat important • Extremely important 	<p style="text-align: right;">5 15 5 30 45</p>																																							
8.	<p>Please tick right on following aspects -</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 30%;"></th> <th style="width: 35%; text-align: center;">Whether you currently hold any of these types of products?</th> <th style="width: 35%; text-align: center;">In the coming two years you will Choose which type of financial products?</th> </tr> </thead> <tbody> <tr><td>An investment account</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Online Banking/Online Trading</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Home Loan</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>A bank loan on Property</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Fixed Deposit</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Mutual Fund</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>A credit card</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Insurance</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Stocks and shares</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Mediclaime Policy</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Current Account</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> <tr><td>Pension Plan</td><td style="text-align: center;"><input type="radio"/></td><td style="text-align: center;"><input type="radio"/></td></tr> </tbody> </table>		Whether you currently hold any of these types of products?	In the coming two years you will Choose which type of financial products?	An investment account	<input type="radio"/>	<input type="radio"/>	Online Banking/Online Trading	<input type="radio"/>	<input type="radio"/>	Home Loan	<input type="radio"/>	<input type="radio"/>	A bank loan on Property	<input type="radio"/>	<input type="radio"/>	Fixed Deposit	<input type="radio"/>	<input type="radio"/>	Mutual Fund	<input type="radio"/>	<input type="radio"/>	A credit card	<input type="radio"/>	<input type="radio"/>	Insurance	<input type="radio"/>	<input type="radio"/>	Stocks and shares	<input type="radio"/>	<input type="radio"/>	Mediclaime Policy	<input type="radio"/>	<input type="radio"/>	Current Account	<input type="radio"/>	<input type="radio"/>	Pension Plan	<input type="radio"/>	<input type="radio"/>	
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9.	<p>Which of the following statements best describes how you last choose?</p> <ul style="list-style-type: none"> • I considered several products/loans/policies/accounts from different companies before making my decision • I considered the various products/loans/policies/accounts from one company • I didn't consider any other products/loans/policies/accounts at all • I looked around but there were no other products/loans/policies/accounts to consider • Don't know 	<p style="text-align: right;">40 20 10 15 5</p>																																							

10.	<p>Which sources of information do you feel most influenced your decision about which one to take out?</p> <ul style="list-style-type: none"> Product-specific information 30 Unsolicited information sent through the post 5 Information picked up in a branch 15 Product specific information found on the internet 20 Information from sales staff of the firm providing the products 30 																																		
	<p>b) Best buy guidance</p> <ul style="list-style-type: none"> Best-buy tables in financial pages of newspapers/magazines 20 Best-buy information found on the internet 40 Specialist magazines/publications 10 Recommendation from independent financial adviser or broker 30 																																		
	<p>c) General advice</p> <ul style="list-style-type: none"> Advice of friends/relatives (not working in the financial services industry) 43 Advice of friends/relatives (who work in the financial services industry) 37 Employer’s advice 20 																																		
	<p>d) Media coverage</p> <ul style="list-style-type: none"> Newspaper articles 18 Television or radio programme 32 Newspaper adverts 30 Television adverts 20 																																		
11.	<p>What are the top 3 things you usually save for? (Select top 3)</p> <ul style="list-style-type: none"> Vacation 20 Clothes 20 Entertainment (ie: concerts, etc.) 10 Technology purchase (ie: computer, PDA, MP3 or DVD player, etc.) 10 Investments 10 Pay for my education 10 Gifts for others 5 Pay off credit card or other debt 5 Buy a house/condo 5 Other (please specify) 5 																																		
12.	<p>Please read some attitude and behavior statements and specify how much you personally agree or disagree about each of the statements:</p> <table border="1"> <thead> <tr> <th></th> <th>Agree</th> <th>Disagree</th> </tr> </thead> <tbody> <tr> <td>Before I buy something I carefully consider whether I can afford it</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I tend to live for today and let tomorrow take care of itself</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I am more satisfied to spend money than to save it for the long term</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I pay my bills on time</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I check my account statement either online or when I receive them in the mail regularly</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I choose saving account based on interest rate</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I choose credit card based on interest rate</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I believe that financial planning to is only important to those have lot of money</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I believe that retirement is too far away to think about</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> <tr> <td>I have taken sufficient insurance in order to face unexpected event</td> <td><input type="radio"/></td> <td><input type="radio"/></td> </tr> </tbody> </table>		Agree	Disagree	Before I buy something I carefully consider whether I can afford it	<input type="radio"/>	<input type="radio"/>	I tend to live for today and let tomorrow take care of itself	<input type="radio"/>	<input type="radio"/>	I am more satisfied to spend money than to save it for the long term	<input type="radio"/>	<input type="radio"/>	I pay my bills on time	<input type="radio"/>	<input type="radio"/>	I check my account statement either online or when I receive them in the mail regularly	<input type="radio"/>	<input type="radio"/>	I choose saving account based on interest rate	<input type="radio"/>	<input type="radio"/>	I choose credit card based on interest rate	<input type="radio"/>	<input type="radio"/>	I believe that financial planning to is only important to those have lot of money	<input type="radio"/>	<input type="radio"/>	I believe that retirement is too far away to think about	<input type="radio"/>	<input type="radio"/>	I have taken sufficient insurance in order to face unexpected event	<input type="radio"/>	<input type="radio"/>	
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<p>13.</p>	<p>Please specify whether you think the following statements are true or false:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 10%; text-align: center;">True</th> <th style="width: 10%; text-align: center;">False</th> </tr> </thead> <tbody> <tr> <td>An investment with a high return is likely to be high risk-</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>High inflation means that the cost of living is increasing rapidly</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>It is usually possible to reduce the risk of investing in the stock market by buying a wide range of stocks and shares.</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>Time value of money should be given importance in investment</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>Saving Account interest rate are usually in the range of Four to Six percent</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>Simple interest is better than Compound interest</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>Lowest Interest Rate Is The Best Loan</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> <tr> <td>Short sightness prevent from Long term wealth creation</td> <td style="text-align: center;"><input type="radio"/></td> <td style="text-align: center;"><input type="radio"/></td> </tr> </tbody> </table>		True	False	An investment with a high return is likely to be high risk-	<input type="radio"/>	<input type="radio"/>	High inflation means that the cost of living is increasing rapidly	<input type="radio"/>	<input type="radio"/>	It is usually possible to reduce the risk of investing in the stock market by buying a wide range of stocks and shares.	<input type="radio"/>	<input type="radio"/>	Time value of money should be given importance in investment	<input type="radio"/>	<input type="radio"/>	Saving Account interest rate are usually in the range of Four to Six percent	<input type="radio"/>	<input type="radio"/>	Simple interest is better than Compound interest	<input type="radio"/>	<input type="radio"/>	Lowest Interest Rate Is The Best Loan	<input type="radio"/>	<input type="radio"/>	Short sightness prevent from Long term wealth creation	<input type="radio"/>	<input type="radio"/>																			
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<p>14.</p>	<p>Which one of the following statements best applies to you?</p> <ul style="list-style-type: none"> • I do not have any real financial goals. • I have some financial goals but I do not know how to make them come true. • I have some financial goals and I have created a plan to make them come true. • I have some financial goals and they are coming true. 	<p>12 52 20 16</p>																																													
<p>15.</p>	<p>Do you have one or more credit cards?</p> <ul style="list-style-type: none"> • Yes • No • Refused 	<p>54 36 10</p>																																													
<p>16.</p>	<p>To the best of your knowledge, what is the interest rate on the credit card you use most?</p> <ul style="list-style-type: none"> • Often less than 10%, • 10% to less than 15%, • 15% to less than 20%, • More than 20%, • You are not sure 	<p>10 20 15 55 10</p>																																													
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I'm very traditional in what I buy	<input type="radio"/>	<input type="radio"/>																																													
I love to shop	<input type="radio"/>	<input type="radio"/>																																													
Getting value for my money is the most important thing	<input type="radio"/>	<input type="radio"/>																																													
It's important to me that companies are socially responsible	<input type="radio"/>	<input type="radio"/>																																													
What I wear says a lot about the type of person I am	<input type="radio"/>	<input type="radio"/>																																													
My friends have a strong influence on what I buy	<input type="radio"/>	<input type="radio"/>																																													
If it comes down to deciding between two similar products or services I'll always choose the one that comes from my own country first	<input type="radio"/>	<input type="radio"/>																																													
Advertising has a big effect on what I buy	<input type="radio"/>	<input type="radio"/>																																													
I like to follow trends	<input type="radio"/>	<input type="radio"/>																																													
I buy products from companies that are fair to its workers	<input type="radio"/>	<input type="radio"/>																																													
I tend to buy a lot of gadgets	<input type="radio"/>	<input type="radio"/>																																													
<p>18.</p>	<p>Would you like to attend workshop to enhance finance literacy in near future?</p> <ul style="list-style-type: none"> • Yes • No 	<p>66 34</p>																																													

19.	<p>What finance topics would you like more information on?</p> <ul style="list-style-type: none"> • Superannuation • Budgeting • Taxation • Borrowing loans and mortgages • Online Banking/Trading. • How to make complaints/resolve disputes • Financial management and planning • Business finance • Retirement planning • Insurance • Shares/Stock market • General banking information. • Consumers' rights and responsibilities • Interest rates • Other responses • Can't say 	
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Table 2: Responses by Retail Investor

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