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FINANCIAL LITERACY IN INDIA: A PERSPETCIVE

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Abstract

Financial literacy is defined as the 'ability of an individual to make informed judgments and to take effective decisions regarding the use and management of money'. It imbibes discipline in the financial dealings of the individuals. The financial illiterates, on the other hand, tend to borrow more, experience difficulty with debt servicing, and incur loses. In addition, they may not understand the terms attached to the loans and mortgages. As a result, it makes them more vulnerable to financial crisis and sufferings. The recent global financial crisis of 2008 in general triggered by the US subprime crisis, bears testimony to the miseries of the innocent borrowers for being ill informed. The scope of financial literacy is not only confined to individual customers but also extends to major players in the financial services industry such as banks and other financial institutions as well as the policy makers who need to be financially literate.Various agencies are engaged in promotion of financial literacy in India. This paper makes a case for financial literacy and presents various initiatives taken by RBI in particular. It also underscores the role of Higher Education Institutions (HEIs) in creation of financially literate societies. This is a conceptpaper with a focus on individual customers in the financial services industry. It is developed on the basis of existing literature on financial literature and the author's personal observations.

Key words: Financial literacy, Informed decisions, Personal finance, 'Ponzi' schemes

Introduction

The development of financial system depends upon well integrated market structures based on appropriate regulatory frameworks with well informed participants. The participants include the regulators, the providers of financial services, and the customers. The strength of the financial system has a bearing on the prospects of each player. The literature on the traditional Indian financial system (money lending and indigenous banking) is replete with examplesof exploitation of the innocent, uneducated and the uninformed borrowers in particular. The exploitation has continued from the ages and has no signs of vanishing away. The recent global financial crisis of 2008 in general triggered by the US subprime crisis, bears testimony to the miseries of the innocent borrowers for being ill informed. The crisis occurred because many borrowers in US were clueless about the terms of the adjusted rate mortgage contracts they were signing as well as unaware of the likely repercussions of these mortgages. The colossal impact of the information gap in these financial service offerings on the individual and institutional participantsworld over is unforgettable.

The players in the financial markets especially the individual participants need to be financial literates so as to be able to effectively manage their financial dealings in the markets. They need to possess the skills and knowledge regarding each and every facet of their financial transactions. Each country needs citizens who are capable of managing their finances so as to emerge as globally competitive economy. From this perspective, the scenario in India is not encouraging. 'NABARD report published in 2008 reveals that 45.9 million households in the country do not have access to credit either from institutional or non-institutional sources. This represents around 51.4% of the total percentage of households. Moreover, despite the large and vast network of bank branches, only 27% of the total households in the rural sector have access to banking services. Rural households not accessing credit from formal sources as a proportion of total households' accounts for a whopping 95.91%, 81.26%, and 77.59% in north, north eastern and central regions of the country' (Nash: 2012).In view of large chunk of population remaining outside the ambit of formal financial system coupled with the low literacy levels, a need is felt to address the issue of financial literacy.

This is a conceptual paper which is organized into five sections. Section one presents a conceptual foundation of financial literacy. Section two discusses the significance of financial literacy. Section three presents an overview of various initiatives taken by the Reserve Bank of India, in particular, for promoting financial literacy in the country. Section four discusses the role of higher education institutions in promoting financial literacy. Section five concludes the discussion.The paper is developed on the basis of existing literature on financial literature and the author's personal observations.

Financial literacy: conceptual foundation

Institutions and individuals (scholars) at international and national levels have reflected on the term 'financial literacy'. Organization for Economic Co-operation and Development (OECD), for example, has defined financial education as 'the process by which financial consumers/investors improve their understanding of financial products, concepts and risks 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' (OECD: 2006).

Financial literacy is defined as the 'ability of an individual to make informed judgments and to take effective decisions regarding the use and management of money' (Noctor, Stoney and Strandling: 1992). 'Personal financial literacy is the ability to read, analyze, manage and communicate about the personal financial conditions that affect the material well being' (Anthes: 2004). 'Financial literacy is a meaning-making process in which individuals use a combination of skills, resources, and contextual knowledge to process information and make decisions with knowledge of the financial consequences of that decision' (Mason and Wilson: 2000). Financial literacy '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 general economy' (Vitt et al: 2000).

Similar comments are available on financial literacy by the Indian scholars and professionals in banking. 'Financial education primarily relates to personal financial education to enable individuals to take effective actions to improve overall well being and avoid distress in matters that are financial' (Das: 2007). 'Financial literacy is expected to impart the wherewithal to make ordinary individuals into informed and questioning users of financial services. It is not just markets and investing but also about saving, budgeting, financial planning, basics of banking and most importantly, about being 'financially smart' (Chakrabarty 2013).

It is clear from the preceding discussion that the players of financial services industry in general and consumers of financial services in particular need right information and skills to manage their financial operations.

Significance of financial literacy

Individuals who are financially literate are: 1) knowledgeable, educated, and informed on the issues of managing money and assets, banking, investments, credit, insurance, and taxes; 2) understand the basic concepts underlying the management of money and assets; and 3) use that knowledge and understanding to plan and implement financial decisions (Hogarth: 2002). The financially illiteracy negatively impacts on the individuals' ability to manage their day-to-day finances- making a saving, depositing/investing the same, financing the retirement etc. The financial illiterates tend to borrow more, experience difficulty with debt servicing,and incur loses.In addition, they may not understand the terms attached to the loans and mortgages. They might also park their surplus in 'ponzi' schemes offering extremely high returns. As a result, it makes them more vulnerable to financial crisis and sufferings.On the other hand, the informed and the knowledgeable consumers demand financial products suiting to their requirements. They don't accept what is being offered but demand what they want. Thus financial literacy among consumers helps narrow the information divide and enable individuals develop efficient household budgets, create savings plans, manage debt and formulate strategic investment decisions for themselves and their families. This phenomenon promotes competitive and efficient financial markets as well as reassures the nation's future financial health.

Promotion of financial literacy

Everyone associated with the financial system needs to be financially literate. This calls for creating awareness on financial products/services, educating them on risk and returns, rights and obligations, consumer protection and grievance redressal machinery. At times, there is also a need to educate the consumers on avoiding debts which are beyond their meansof repayment. This demands building up the required financial literacy material in simple vernacular languages and disseminating them through various channels of mass communication. The financial literacy camps can also be arranged as part of promotion.

Various agencies are involved in promotion of financial literacy in India. The initiatives taken by RBI in particular, deserve special mention. Some of the steps that have been taken by the

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Reserve Bank of India and other stakeholders to promote financial literacy in India are as under (Chakraborthy: 2013):

Outreach visits:The top executives of Reserve Bank of India visit remote villages. The objective of these visits is to understand the ground level position, spread awareness about benefits of being connected to the formal financial system and disseminate information about the functioning of RBI.

RBI website*:* A link on financial education in RBI website is created. It contains material on financial education in English, Hindi, and 11 other vernacular languages. It is in the form of comic books on money and banking for children, films, messages on financial education. There is also a link for accessing the Banking Ombudsman Scheme.

Awareness*:*RBI encourages the creation of awareness on financial literacy. This is done in the form of distributing pamphlets, comic books, enacting plays and skits. It also arranges for putting stalls in local fairs, exhibitions, participation in information/literacy programmes organized by press. Further, books on financial planning for students and new professionals have also been released.

Financial Literacy Centres (FLCs):RBI has mandated the banks toopen Financial Literacy Centres with a view to spread financial literacy, to create awareness about financial products and provision of counseling facilities for customers of banks. There were 575 FLCs in the country as on September 30, 2012.

Town-hall events*:* Events on financial literacy are conducted in the town halls across the country including in Tier II and smaller cities. The commercial banks and other stakeholders are brought together in these events.

Monetary museum: RBI has set up a monetary museum to create awareness about money and banking among the general public and to spread knowledge about the history of money.

Mobile Vans*:* Mobile financial literacy vans are used by banks for spreading the message of financial literacy especially in the North Eastern States.

Awareness on government schemes: Programmes on creating awareness about various government sponsored self-employment schemes involving bank loans and subsidy by government agencies like KVIC, DICs and SC/ST corporations are conducted.

Media campaigns: RBI encourages the use of mass media for creating financial awareness. Mass media campaign tie-ups are found with financial market player, educational institutes, and NGOs relating to financial awareness workshops/help lines, books, pamphlets and publications on financial literacy.

Field functionaries:National and state level rural livelihood missions have large number of field functionaries for proper handholding support in general and promoting financial literacy in particular, to large number of Self-Help Groups. Further, financial literacy programmes are conducted by Rural Self-Employment Training Institutes.

Websites/portals: A large number of websites/portals of banks/state level bankers committees disseminating information on banking services are created for promoting financial literacy.

RBIQ:RBI launched the RBIQ, an all India inter-school quiz competition in 2012. The quiz seeks to be an effective platform for disseminating financial education by creating awareness and sensitization about the history and role of the RBI, about banking and finance, economics, current affairs, etc. This event seeks to build a connect between the RBI and the young student community enrolled in schools across country.

Financial Literacy Guide: The Reserve Bank of India has released on its website on January 31, 2013, a comprehensive Financial Literacy Guide. The financial literacy guide consists of guidance note for trainers, operational guidelines for conduct of financial literacy camps, financial literacy material including posters. The guide also contains a financial diary to be distributed to the target audience so as to enable them to keep a record of their income and expenses, as a first step towards financial planning.

Role of HEIs in promoting financial literacy

The higher education institutions can play a significant role in promoting financial literacy. The HEIs especially engaged in imparting business education own responsibility as well for preparing a new generation of financially literate individuals and societies. The approaches that can be adopted by HEIs in promotion of financial literacy are listed hereunder:

- Offer orientation to students on opening bank account in the college premises, encourage them remit through cheques, guide on the use of credit cards etc.
- Guide students in preparing their personal budget indicating their sources (income) and expenses during their studies in the institutes
- Invite local bankers for orienting students on various banking facilities and schemes for the students
- Send regular e-mails on financial tips to students by the faculty teaching Finance
- Motivate students to educate the people in their localities on spending habits and financial planning
- Conducting workshops on personal finance for the members of the unorganized and undermanaged sectors
- Offer financial counseling services to the extravagant students on the similar lines of academic counseling to slow learners
- Requiring students of the final semester to submit their future budget for next five years indicating their potential salaries and expenses
- Develop websites for promotion of financial literacy
- Design and deliver free courses on money management to the local people as part of academic social responsibility
- Guide the school teachers, and small business men in the locality in tax filing procedures
- Encourage the students to conduct Finance Quizzes to students of the local schools
- Set up Money Management Centre in the institutes, and bring out brochures, pamphlets and newsletters on money management

It is evident from the preceding discussion that the HEIs can play a significant role in creating a financially literate society. The initiative of the Department of Studies in Commerce, University of Mysore, Mysore, in taking up U.G.C. Special Assistance Programme (DRDS-I) on Agri-Risk Management' as thrust area in itself bears testimony to the Department's commitment to creation of a financially literate society in general and the financially literate agricultural community in particular. This is evident from the vision of the SAP of the Department that is crafted in its concept paper: "The poor penetration and development of various risk mitigation tools in the country represent huge opportunities for the emerging agricultural insurance, commodity futures markets and weather derivatives markets providing for effective sharing of risk by a larger section of the society. The strategy should involve moving risk management solutions towards a sustainable actuarial regime by not only increasing the effectiveness of existing instruments but also creating innovative ART (Alternate Risk Transfer) mechanisms for effectively pooling, sharing and transfer of risks. There is an urgent need to promote studies, research and training in these related areas". These lines depict the concern for the financial literacy on a broader canvas of a critically significant sector of the Indian economy. This is a stimulating agenda for other HEIs in the area of financial literacy.

Conclusion

Promoting financial literacy is the need of the hour. The necessary knowledge and skills are to be imparted with a view to make the financial life of the society clean, safe and happy. The information on financial prudence needs to be disseminated in simple vernacular languages using mass media. The large volume of information especially found in the fine-print media should be done away with. As a result, the problem of information asymmetry between the financial intermediary and the end-users of financial services is well addressed. This goes a long way in creating a more competitive and efficient financial markets as well as impacting on the financial health of the individuals, families, communities and the nation at large. This in turn ensures a strong and globally competitive economy. The promotion of financial literacy calls for an active involvement of policy makers, financial sector regulators, financial institutions, and the end-users. The role of NGOs and educational institutions in promotion of financial literacy at the grass root level is phenomenal. In addition to the individual customers of the financial services industry, the major players in the financial services industry such as banks and other financial institutions also need to be financially literate. They need to have a complete understanding of the risks involved in their service offering as well in their business

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as a whole. Even the policy makers need to be financially literate that would enable them in designing an appropriate policy framework for promoting financial literacy.

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