

# Financial Literacy: An Awareness Study

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## ABSTRACT

Financial literacy is often understood only in the contemporary context. The phrase conveys something comprehensive and yet it is interpreted in a limited manner. It is interpreted as the ability to understand finance – in particular, the skill sets that one needs to possess to make informed and effective decisions through their understanding of finances. This interpretation is right but by no means exhaustive. If this narrow interpretation is invoked, then only a small percentage of Indians will qualify as a financially literate people.

## 1. Introduction

Almost all inhabitants of rural India will fall outside the purview of this interpretation. Almost all Indians that inhabit the urban landscape and some Indians that inhabit the semi-urban landscape will qualify as a financially literate people. This kind of inference is arrived at because of the inadequate manner in which the phrase financial literacy is understood or interpreted most of the time and by most of the people in the Indian context. Nothing can be farther from the truth. Financial literacy levels in India are unfortunately appraised the way they are appraised in advanced economies. For example, in advanced economies the following factors (the list is illustrative and not exhaustive) are typically considered to judge if financial literacy obtains in a given sample of people:

1. The exposure of the people to the concept of compound interest
2. The inclination of consumers to seek the relevant information before they buy a product or a service
3. The ability of the people to make investment decisions
4. The ability to understand the nitty-gritty of credit cards, savings schemes, the retirement nest egg schemes, awareness of risk and risk-mitigation tools like insurance

The people of India have been exposed to financial literacy although not all of them have exposure to formal education or are inclined to pursue formal education. But this fact should not be held against the people to argue that they lack financial literacy. The reason is simple (even if the yardstick used by the advanced economies is applied): The Indian villager understands compound interest; the rural Indian consumer seeks information about the product or service he / she is being persuaded to buy; the rural Indian investor can make investment decisions – he / she knows that gold is the best hedge against inflation. Of course, he / she does not understand the nitty-gritty of credit cards or savings schemes or the retirement nest egg schemes but this ignorance cannot and should not lead one to conclude that the individual in question is financially illiterate. Alas, this is what is happening most of the time, now!

## 2. Review of Literature

1. Bilal Zia<sup>1</sup> argues that financial literacy has become an immensely popular component of financial reform across the world. As a response to the recent financial crisis, the United States government set up the President's Advisory Council on Financial Literacy in January 2008, charged with promoting programs that improve financial education at all levels of the economy and helping increase access to financial services. In the developing world, the Indonesian government declared 2008 "the year of financial education," with a stated goal of improving access to and use of financial services by increasing financial literacy. Similarly, in India, the Reserve Bank of India launched an initiative in 2007 to establish Financial Literacy and Credit Counselling Centres throughout the country which would offer free financial education and counselling to urban and rural populations. The World Bank also has not been missing out on the trend – it recently approved a USD 15 million Trust Fund on Financial Literacy. But we know not much about financial literacy. Does it work, and if so, through what mechanisms? Despite the money being ploughed into financial literacy programs, we know very little to address these important questions. While it is true that there is a large and growing body of survey evidence from both developed and developing countries that demonstrate a strong association between financial literacy and household well-being, we are still in the process of learning whether this relationship is causal. While survey analysis can control for all observable variables in the survey questionnaires such as income, gender, age, education, etc., there may be some unobserved variables, such as ability, that may be driving the positive correlation between financial literacy and the use of financial services. In addition, people who choose to participate in surveys or literacy seminars may be quite different in terms of their interests in financial matters, for instance, than those

<sup>1</sup> Source: <http://blogs.worldbank.org/allaboutfinance/the-fad-of-financial-literacy>

who do not participate. The positive correlations may therefore be driven by endogenous selection. Further, survey evidence cannot distinguish the direction of causality: greater financial literacy may lead to greater use of financial services, or just as likely, individuals who use more financial services may score better on financial literacy assessments based on their experience in financial markets.

Experimental studies on financial literacy, similar to medical drug trials, allow for overcoming the problems of selection and endogeneity that are associated with survey analysis. There are only a handful of completed studies on financial literacy, though more are in the pipeline. In the developed world, research evidence that financial education can affect decision-making comes from a randomized evaluation conducted at a major university in the United States.

In a paper the researcher co-authored with Shawn Cole and Thomas Sampson, the researchers provide the first study in this direction in the developing world, through a randomized evaluation of a financial literacy training program in Indonesia. Participants in this study consisted of unbanked households, half of whom received an invitation for a free financial literacy seminar 2-3 hours in length. Although the take up of the training was high, the researchers found no effect of the program on the likelihood of opening a bank account in the general population. They however, found that the training had a significant impact on unschooled and financially illiterate households, increasing the likelihood of opening a bank account by 12% and 5%, respectively. These results suggested that financial literacy training programs should be carefully targeted at these subgroups of individuals. Additionally, a more comprehensive financial literacy program that is delivered over several weekly sessions, rather than a single session of a few hours, may be required to change financial behaviour among households in the general population.

2. The need for a more detailed and extensive financial education program is also reflected in a research conducted by Cole, Gine et. al (2009) on rainfall insurance for low-income farmers in Andhra Pradesh, India. Specifically, they randomize the provision of an education module about converting the measurement of rainfall in millimeters to soil moisture. Since farmers typically decide when to sow using soil moisture whereas insurance payouts are calculated using millimeters, the education module should improve farmers' understanding of the insurance policy. However, results indicated that the education module had no significant effect on insurance participation, possibly because the intervention was quite minimal. The education component only involved using a ruler to demonstrate a length of 10 mm and 100 mm, and subsequently showing a chart of how 100 mm of rain translates into average soil moisture for a particular soil type. Moreover, the information was presented

quite briefly, taking no more than 2 to 3 minutes. Thus, a modest amount of financial education appears to be insufficient in inducing households to participate in financial markets, and a more thorough financial literacy program may be necessary to do so.

The researchers argue that financial engineering offers the potential to significantly reduce consumption fluctuations faced by individuals, households, and firms. Yet much of this promise remains unrealized. In this paper, the researchers study the adoption of an innovative rainfall insurance product designed to compensate low-income Indian farmers in case of deficient rainfall during the primary monsoon season. They first document relatively low levels of adoption of this new risk management technology: only 5-10% of households purchase insurance, even though rainfall variability is overwhelmingly cited by households as the most important risk they face. They then conduct a series of randomized field experiments to test theoretical predictions of why adoption may be low. Insurance purchase is sensitive to price, with an estimated extensive price elasticity of demand between -0.66 and -0.88. Credit constraints, identified through the provision of random liquidity shocks, are a key barrier to participation, a result also consistent with household self-reports. Several experiments find an important role for trust in insurance participation. They find mixed evidence that subtle psychological manipulations affect purchase, and no evidence that modest amounts of financial education changes participation decisions. Based on their experimental results, they suggest preliminary lessons for improving the design of household risk.

It is clear from the reviewed literature that what is regarded as financial literacy in the contemporary world does not actually succeed in gauging the familiarity of the people of India with finances and finance-related activities. People who are regarded as financially illiterate may actually be better informed about finances and finance-related concepts and activities than the so-called financially-literate people. This is true of India where for example the wealth of an individual is not gauged by the market value of the securities the individual holds as is the case with the advanced economies. Here, the market value of the various immovable properties that the individual in question holds as also the value of precious metals and stones like gold and diamonds that the individual holds counts as wealth. In the light of this conceptual difference in approach this study sets out to bridge the extant research gap.

### 3. Data Collection & Research Methodology

The methodology applied is analytical in nature. It analyses the problems faced in implementing the concept of financial literacy in a country where financial literacy obtained much before it was invented and implemented in the west.

Data required for the research has been collected from both primary and secondary sources. Primary data has been collected from 25 respondents who according to the present-day definition of financial literacy are not financially literate. In

addition, the researcher has interacted extensively with other stakeholders associated with the financial literacy programme. Secondary data has been collected from reputed journals, magazines, newspapers and financial websites.

**4. Research Questions**

In the context of the oft-repeated allegation that financial literacy is important to ensure that the entire population of the country is served optimally by institutional finance, the study has set for itself the following objectives:

1. To ascertain if financial literacy is really wanting in India
2. To ascertain if the financially-illiterate people believe that they have contributed to the country's economic growth
3. If so, to seek justification from them for holding such a view

**5. Analysis of Data**

Familiarity with financial concepts and financial products

The respondents were posed questions on the various financial concepts and financial products in so far as they related to their main economic activity and allied activities, the main activity being agriculture and the allied activities covering dairy and horticulture, amongst other things. Their responses to the query revealed that they were not as financially – illiterate as it is generally believed. The following Table depicts their replies.

**Table-1**

**Familiarity with financial concepts and financial products**

Financial concepts / products	No of Respondents
Familiarity with compound interest	25
Familiarity with investment in gold	25
Familiarity with tenancy laws	25
Familiarity with laws relating to immovable properties in particular agricultural land	25
Familiarity with the availability of institutional finance	25
Familiarity with land ceiling laws	25
Familiarity with investment in precious stones like diamonds	9
Familiarity with insurance products concerning crops, livestock and life	7
Familiarity with commodity markets	4
Familiarity with wealth tax laws	3
Familiarity with income tax laws	0
Familiarity with capital market	0

The respondents are familiar with the concept underlying compound interest and laws concerning tenancy, immovable property and land ceiling. They are familiar with important investment avenues too – like investing in gold. They are aware that institutional finance is accessible.

However they have scant regard for investment in precious stones like diamonds. They do not have adequate exposure to risk-mitigating instruments like insurance products. Their familiarity with the commodity markets leaves a lot to be desired. Their familiarity with income tax laws and capital market is nil.

It is clear from the analysed data that financial literacy does obtain in the country albeit in a form that is at variance with the contemporary definition. It cannot be said that financial literacy is wanting in the country, in view of the foregoing facts – it of course can be improved.

**Contribution of the supposedly financially-illiterate people to the country's economic growth**

Given the supposedly inadequate levels of financial literacy levels obtaining in the country in the contemporary sense, the researcher sought to ascertain from the respondents if they believed that the financially illiterate people had contributed to the country's economic growth. The respondents' replies to the queries appear in the following Table.

**Table-2**

**Contribution of the supposedly financially-illiterate people to the country's economic growth**

Whether the supposedly financially-illiterate people have contributed to the country's economic growth	Number of Respondents	Percentage
Yes	25	100
No	0	0
<b>Total</b>	<b>25</b>	<b>100</b>

The unanimity in the views of the respondents is surprising, to say the least. Their so-called financial illiteracy notwithstanding, they have contributed to the country's economic growth, according to them.

**Justification of the view that the financially-illiterate people have contributed to the country's economic growth**

Since the respondents are of the view that financial literacy obtains in India albeit in its own form given the contribution of the financially illiterate people to the country's economic growth, the researcher requested the respondents to justify their view. Their justification is reflected in the following Table.

**Table-3**

**Justification of the view that the financially-illiterate people have contributed to the country's economic growth**

Justification	Number of Respondents
Many leading businesses in India were founded by the so-called financially illiterate people.	25
When the global meltdown affected the leading economies of the world, India was only moderately affected because the so-called financially illiterate people of India ensured a bumper harvest	25
Gold reserves with the people of India (or private gold) are the highest in the world given their conviction that it is the best hedge against inflation	25

Even today India is the largest importer of gold in the world and the largest consumer of gold in the world which testifies to the fact that they invest in gold as a store of value and regard such investment in gold as the best hedge against inflation.	25
Indians' steadfast resistance to conversion of agricultural land into commercial / industrial land has ensured that the country's inherent strength in agriculture has remained more or less intact.	25

## 6. Conclusions & Recommendations

1. People familiar with the concept of compound interest and the advisability of investing in gold can by no stretch of imagination be called financially illiterate.
2. People familiar with tenancy laws and laws relating to immovable property cannot be called a financially-illiterate people. They may not have picked up these laws through the channel of formal education but they have been following certain well-established principles and procedures since time immemorial and they have stood the test of time.
3. People who are familiar with institutional finance cannot be regarded as financially-illiterate
4. The reluctance of the people to place the same amount of faith in precious stones like diamonds as they do in gold shows that they are mature investors and mature investors can by no stretch of imagination be called financially-illiterate.
5. The respondents are not familiar with insurance products, commodity market products, tax laws and the capital market but this again does not imply that they are financially illiterate, although it can be said that familiarity with these products will improve their financial literacy levels.
6. Some of the leading Indian business houses were established a generation or two ago by the so-called financially-illiterate people. Theoretically the two cannot be true or go together. This only implies that the universal definition of financial literacy cannot be applied to India – it has to be defined in the Indian context.
7. It is the so-called financially-illiterate people of India who helped the country weather the storm generated by the global economic meltdown by helping the country reap a bumper harvest and even helping the country sell the agricultural produce in the global market at lucrative prices.
8. The traditional resistance of the so-called financially-illiterate people of the country to conversion of agricultural land into commercial / industrial land has ensured that the country will always have something to fall back upon as happened during the recent economic meltdown.

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