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Financial Literacy – Problems and Challenges

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ABSTRACT

Financial literacy has gained importance for country like India where literacy rate is low and people in rural areas are still out of access of basic financial set up and services. The financial market has been dramatically changing after liberalization and has been offering several opportunities not only for investor but also for the corporate. Today financial services are becoming more accessible, financial market offers myriad of products with intricate features and services, leaving many people ill equipped to cope up with the sophisticated financial needs. The economies around the world have increasingly considered financial literacy as a key pillar for the development of their financial system. This study depicts the financial literacy and its problems and challenges the ability to process financial information and make informed decisions about personal finance which has received growing attention in the developed markets and, emerging markets as a potentially important determinant of household well-being.

1. Introduction

Financial literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being. Financial Literacy is the process by which individuals gain an understanding of their financial situation and learn how to strengthen it over a period of time by inculcating the financial habits of savings, budgeting, planning and hence making the right financial decisions. The focus of any discussion on financial literacy is mainly on the individual, who usually has limited resources and inadequate skills to understand the complexities of financial dealings with financial mediators on a day to day basis. Financial education has achieved greater significance in recent years due to complex financial markets and rapid growth in financial products. Financial Literacy helps individuals to manage their financial affairs such as savings, investments, credit, retirement decisions, etc. and improve their standard of living which ultimately helps in the growth of the whole economy. In India, the need for financial literacy is even greater because of the low levels of literacy and prevalence of large sections of the population which is still out of the formal financial set-up.

Financial Literacy is considered an important addition for promoting financial inclusion, consumer protection and ultimately financial stability. Unfortunately, India ranks lowest in financial literacy amongst Asia-Pacific countries. However the results are poor but on a positive note a lot of initiatives are taken by RBI and other financial bodies to increase financial literacy. The present paper is an attempt to throw some light on the present scenario of financial literacy in India as well as initiatives taken by regulatory bodies to enhance the level of investor literacy in India.

2. Statement of the problem

Financial planning is a must for every individual. Domestic financial stability remains a crucial challenge in many households, and the recent economic crisis has confirmed that now days, the skills related to personal financial management have gained more importance than ever. The financial market is now getting more complex. Today's financial market is riskier, global and innovative. Financial market is now full of new and complex financial products which has emphasized on the fact that empowerment of financial consumer is must. For this purpose financial literacy has become a necessity in current societal and financial context. Financial literacy is the ability to process financial information and make informed decisions about personal finance. Policymakers in both developed and developing countries are increasingly recognizing the importance of financial literacy and of investing resources in financial education programs.

3. Objectives of the study

- To understand the reasons behind financial illiteracy in Indian society.
- To emphasize the need of financial literacy in current scenario.
- To know what the financial sector regulatory bodies/authorities are doing for enhancing financial literacy.
- Role of Regulatory authorities towards improvement of financial education in India.

4. Research design

The design of research study is exploratory. The data used is secondary *i.e.* data is collected from various sources such as magazines, journals, research papers etc. Different websites are also being studied to collect the required data.

5. Financial literacy and financial inclusion are integral to each other

Financial inclusion and financial literacy are integral to each other.

- They are two elements of an integral strategy.
- Financial inclusion provides ***access***

- Financial literacy provides ***awareness***
- Disadvantaged people need both – ***access to and awareness*** of financial services.
- Financial inclusion – supply side
- Financial literacy – demand side

6. Importance of financial literacy

A majority of our households are not using modern financial markets. Even among those who are, most are not doing it well. Low knowledge among households of financial markets, concepts and products has a direct impact on mass-scale utilization of financial markets. Financial literacy also plays a significant role in efficient allocation of household savings and the ability of individuals to meet their financial goals. Financial literacy also means the ability to seek sound financial advice. Financial literacy is considered an important element for promoting financial inclusion and ultimately financial stability. Financial literacy would benefit the financially-excluded by enabling them to understand the benefits and the ways to join the formal financial system. It could also benefit the financially included by helping them make informed choices about the products and services available in the market to their best advantage.

Individuals will not be able to choose the right savings or investments for themselves, and may be at risk of fraud, if they are not financially literate. But if individuals do become financially educated, they will be more likely to save and to challenge financial service providers to develop products that truly respond to their needs, and that should have positive effects on both investment levels and economic growth. Financial decisions can be difficult. Comparing savings or borrowing options with different interest rates and term structures can be difficult for those who are not financially safe—and even a knowledgeable individual may need to rely on calculators or spreadsheets to make truly informed decisions. Yet, many households are not knowledgeable, and often receive little assistance when making these decisions. Moreover, unlike the decision to visit a restaurant or purchase a particular car, customers may not receive useful feedback on the value of the financial product they have purchased, making the typical learning process even more difficult.

So, Financial literacy—the ability to process financial information and make informed decisions about personal finance has received growing attention in the developed markets and, emerging markets as a potentially important determinant of household well-being.

7. Financial education

Financial education is important; it is only one pillar of an adequate financial policy to improve financial literacy and access to financial services. Financial education can complement, but can never replace, other aspects of successful financial policy such as consumer protection and the regulation of financial institutions. Financial education should also go hand-in-hand with improving access to financial markets and services. Access to financial services is a significant issue in many emerging economies.

The purpose of education is to teach people to deal with financial decisions more intelligently and with greater sense of confidence.

- make it interesting
- make it instructive
- make it relevant to the age and income group

The elements of the curriculum should be help to educate on following issues;

- To safeguard the money.
- To Plan for retirement.
- To understand complex financial products; which may offer high rewards; but may be associated with high risks.
- To invest wisely, so as to maximize earnings and minimize risk exposure.

In the era of global integrated financial market importance of financial education cannot be overruled. The relevance of financial education is stated as under-

- Financial literacy and education is of particular relevance to emerging economies. As these economies endeavor to improve the financial situation of their citizens by achieving higher economic growth rates
- Financial Education offers many employment opportunities to the people around the world.
- Enhancement of financial literacy would help improve the financial well-being of their people even further through sound financial decision making.
- The Financial education can help a person to understand the risk and return related to the fund invested in different financial product.
- Financial education helps in looking into a financial investment from various angles, and evaluating the various alternatives.

8. Role of regulatory authority towards improvement of financial education

With the advent of the global economic crisis, the need for financial literacy has become more evident. Globally, many countries defaulted in debt payments and hundreds of thousands of common individuals faced critical financial problems in their life. In India too, many individuals who had taken debts or made bad financial decisions in the boom period faced enormous difficulties and challenges in their financial life. Therefore, Financial Literacy is not an option anymore!

So, the government is in the process of setting up the “Financial Stability and Development Council (FSDC)” which will focus on financial inclusion and financial literacy. Presently, there are only a few organizations in India working in the field of financial literacy. These are as follows:

1. **RBI** – The Reserve Bank of India is quite active in the field of financial literacy in India. RBI has designed comics on money and banking which can be downloaded for free on the website ww.rbi.org.in/Financial Education. RBI’s

main focus remains on financial inclusion and financial literacy is one of the areas which it is trying to spread awareness about. RBI has directed that public and private banks take up the cause of financial inclusion aggressively while not giving the same attention towards financial literacy. Therefore much needs to be achieved by RBI in terms of making financial literacy and education a mass movement in India.

RBI in collaboration with Organization of Economic Development (OECD) has issued a concept paper, promoted a financial literacy website, and set up credit counseling centers to provide advice on personal finance. RBI's 'Project Financial Literacy' aims at disseminating information about the central bank and basic banking concepts through various media like films, games, cartoons and comic books, and essay writing competitions, specifically target school and college-going students. Various corporate banking organizations have also promoted financial literacy drive, mostly as part of their Corporate Social Responsibility.

A notable achievement has been made by Kerala by achieving total financial inclusion. At least one member of every household of the state has a bank account. Kerala now tops the Index of Financial Inclusion (IFI) prepared by RBI.

2.**SEBI** – Many investor associations focused on the stock markets are registered with SEBI. SEBI undertakes investor awareness programs through its department of National Institute of Securities Markets (NISM).

3.**MCA** (IEPF) – The Ministry of Corporate Affairs is spreading financial and investor awareness through the Investor Education and Protection Fund. The focus of MCA is however more geared towards adult programs primarily comprising of investor awareness camps.

4.**ICAI, ICSI, ICWAI** – These organizations have their own financial literacy and investor awareness programs and also get support from the MCA and other government departments for spreading financial literacy. These institutions are focused on creating investor awareness among the middle income segment and their own member communities, rather than programs for the general public.

5.**Stock Exchanges** – NSE, BSE, MCX, and others also have programs on investor awareness and regularly release articles and propaganda related to financial literacy. These organizations are not really focused on financial literacy but on increasing the public participation in the stock markets.

9. Issues and challenges

Anecdotal evidence has shown that only 46 per cent of the world adults as having access to financial services. Improving the global average level of financial inclusion has, therefore, become a global challenge. The dearth of access to financial services by billions of adults all over the world poses serious challenges to global economic growth and development. The challenge of inadequate financial inclusion is not just for the developing economies alone, from the emerging to high-income countries, government conceive and implement policies that seek to ensure majority of the population become financially included. "Beyond the non robustness and inefficiencies of the financial system which contributes to the act of being excluded or included, the more fundamental issue of suboptimal macroeconomic environment in the form of low income capacity and pervasive poverty level among the populace has played a more critical role of eroding the eligibility of the bulk of the financially excluded". Specifically, he noted that the major challenges within the general economic conditions have manifested in the forms of:

- A major challenge in the financial inclusion process is how to ensure that the poor rural dwellers are carried along considering the lack of financial sophistication among this segment of the society due to the general low level of financial literacy.
- There is also the challenge of increasing poverty. Though the economy has been reported to have grown at an average of 7.0 per cent, unemployment rate continue.
- The uncompetitive wage levels, particularly in the public sector where a large number belong to the low-cadre means that these groups are excluded financially. Though their salaries are paid into the bank but the personnel only visit the bank once in a month to collect their salaries with little or nothing to save.

10. Recommendations and suggestions

Financial Literacy is the ability to grow, monitor, and effectively use financial resources to enhance the well - being and economic security of oneself, one's family, and one's business. Recognizing the need for financial education, many countries, both developed and developing, have launched financial education or financial literacy programmes for their people. The OECD has brought out "Recommendations on Principles and Good Practices for Financial Education and Awareness", which is furnished below:

- Governments and all concerned stakeholders should promote unbiased, fair and coordinated financial education.
- Financial education should start at school, for people to be educated as early as possible.
- Financial education should be part of the good governance of financial institutions, whose accountability and responsibility should be encouraged.
- Financial education should be clearly distinguished from commercial advice; codes of conduct for the staff of financial institutions should be developed.
- Financial institutions should be encouraged to check that clients read and understand information, especially when related to long-term commitments or

financial services with potentially significant financial consequences: small print and abstruse documentation should be discouraged.

- Financial education programmes should focus particularly on important life-planning aspects, such as basic savings, debt, insurance or pensions.
- Programmes should be oriented towards financial capacity building, where appropriate targeted on specific groups and made as personalized as possible.
- Future retirees should be made aware of the need to assess the financial adequacy of their current public and private pension schemes.
- National campaigns, specific Web sites, free information services and warning systems on high-risk issues for financial consumers (such as fraud) should be promoted.

11. Conclusion

For enhancing financial literacy, the focus on the common man is particularly necessary in India. Financial literacy is important because better-educated consumers will make sound decisions. The benefits of enhanced financial literacy may be great. On a personal level, individuals may save more and manage their financial affairs in a better manner. There may even be general equilibrium effects: increased demand households for financial services may improve risk sharing, reduce economic instability, improve intermediation, and speed overall financial development. This in turn could facilitate competition in the financial services sector and, ultimately, more efficient allocation of capital in society by giving the emphasis on education in India, it should be possible to enhance the financial literacy of youngsters relatively quickly by adding relevant colleges.

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