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Saving and Investment Pattern of Rural and Urban Households: A Conceptual Model

[1]Dr. Shashi Kala & [2]Amaninder Kaur Dheendsa

[1]Assistant Professor, University School of Business Studies, Punjabi University Regional Campus, Talwandi Sabo (India)
[2] Research Scholars, School of Management Studies, Punjabi University, Patiala (India)

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ABSTRACT

People save so that they can consume more in the future. A decision to spend now or save is solely a personal choice made by the income earner. But this decision depends upon a variety of factors which include disposable income, real interest rates and demographic factors to name a few. People have different behaviour towards savings and disparities in income levels. There are people who believe that money obtained today must be used to meet present needs and the future will care for itself. There are others who also hold the view that no matter how little one's income is there is the need to save part of that income. The objective of this paper is to develop and propose a conceptual model that studies the influence of different determinants on the savings of households. This paper will help the marketers and the government to formulate strategies focussing on these determinants so as to increase savings. Increased savings would in turn help achieve the objective of economic growth of the state as well as the country.

1. Introduction

Savings represent that part of the income which has not been spent on consumer goods and services. It is the difference between income and expenditure.

"The saving of the household sector can be measured by (i) total financial saving and (ii) saving in the form of physical assets. The financial saving includes possession of currency, net deposit, investment in shares, debentures and govt. securities and small saving whereas the physical assets include machinery, equipment, construction, inventories etc. held by an individual." (Singh, 2011)

This saving is further converted into an investment. Investment is an asset or item that is purchased with the hope that its value will increase in future and it will generate desired income when needed. Sound investment is responsible for healthy economic growth of the country. For any individual it is important that there should be some amount of saving so that sound investment can occur.

The economic development of a country is based on the savings and investments of that particular country. Savings have a direct relation with the income levels of people. There are changes in the saving and investment pattern due to the varied income levels and various socio-economic and demographic factors. (Singaram, 1998)

Therefore, income becomes the main source of savings as said by Keynes (1936). There are many sources of income such as salary, business profit, corporate profit, interest payments and earning from farm production, etc.

2. Conceptual Framework

2.1 Savings

Savings have been rightly regarded as income that is not consumed by immediately buying goods and services by Issahaku (2011) in his analysis of the determinants of saving and investment in Nadowli district of Ghana. He found that there exists a close relationship between savings and investment by using a microeconomic approach. Thus by not consuming income it gets used for savings and further investment. This investment plays a strategic role towards economic growth.

There is great amount of disparity in rural and urban population in terms of income, expenditure and saving. This disparity among the rural urban savings can also be due to the socio-economic and demographic factors as highlighted by Rao and Saheb. "...diverse socio-economic, demographic and cultural factors are reflected in the inequality in the distribution of consumption expenditure as it is revealed by the national sample survey organization data on consumption expenditure in India." (Rao&Saheb, 2012)

Savers determine in advance the amount that will be set aside by them for investment. But this depends on three factors that have been discussed by Dellien (1997) in his research highlighting the study of Wai. These include: the ability to save, the willingness to save and the opportunity to save. Distinctly, the opportunity to save then becomes the dominant factor in the choices which govern the allocation of disposable income to varied investment avenues.

2.2 Determinants of household savings

"Households' saving behaviour is largely influenced by several variables like the perception of saving of those who save, their ability, willingness, objectives or motivations for saving and the opportunity to save." (Michael, 2013).

It has been clearly highlighted in previous studies that a number of factors affect the ability to save, the will to save and

the opportunity to save, and the saving pattern of a household depends largely on these very factors.

2.2.1 Income

The most crucial and indispensible determinant of savings as highlighted by almost all the previous researches is income. Different methodologies have been used to study the relationship among these two variables and "all have found a positive relationship between income and savings." (Michael, 2013). Certain theories have also been propounded based on the results.

Kraay has highlighted that "saving rates and levels of income per capita exhibit a modest positive correlation in a cross section of provinces and a considerably stronger time series correlation within provinces for urban households. This lends credence to the importance of subsistence consumption in household saving decisions, with average saving rates rising as household income progresses beyond thebare minimum required for survival."

Evidence from the Soviet Union shows that there exists a "stable relationship between real per capita household saving and real per capita disposable income in the Soviet Union. The substitution of a formulation of permanent income for current income improves the relationship and indicates that saving is influenced by recent past income and that households save a substantially larger proportion of transitory than permanent income." (Pickers gill, 1976).

The findings in Ghana do not differ from what Athukorala&Sen (2004) also found in India even though both used different approaches. They found a positive relationship between income and savings in India just as other researches.

Athukorala and Sen (2004) noted in their analysis of the determinants of private savings in the process of economic development in India from 1954 – 1998 that real interest rate return on bank deposit had a statistically significant positive effect on Indian's savings behaviour. The income growth variable was found to be an important determinant of the private savings rate. The Keynesian 'absolute income hypothesis' was found to hold for savings behaviour in India.

Though varied methodologies were used by researchers, but to one end that signifies income as a prime determinant of savings. The findings of authors depict a positive relationship between income and savings.

2.2.2 Interest rate

Rate of interest exerts influence on the way in which any given level of aggregate disposable income is allocated between consumption and savings. The interest rate that an investor gets in return, answers the very question that why an investor saves in the first place. (Roopa, 2004)

An individual without some inducement would never postpone the enjoyment of consumption to some future date. Interest is therefore, the inducement which is essential for savings. "The rate of interest must be high enough to bring forth the Marginal inducement of savings in order to meet the aggregate demand for capital." (Marshall, 1949)

Earning interest can therefore be viewed as the main motive behind the act of savings by individuals. Although this cannot be viewed to be the only motive.

2.2.3 Motives for Savings

Patti J. Fisher, Catherine P. Montalto (2010) in their paper "Effect of saving motives and horizon on saving behaviors" have highlighted the very basic theoretical economic model on which the concept of saving motives is based which was given by Keynes. They present that "Keynes (1936) first discussed saving motives, identifying eight different motives, to which Browning and Lusardi had added one motive, providing a title for each: (1) precautionary motive, (2) life-cycle motive, (3) inter-temporal substitution motive, (4) improvement motive, (5) independence motive, (6) enterprise motive, (7) bequest motive, (8) avarice motive, and (9) down payment motive."

Schunk, D (2009)conducted his study in order to find out the co-existing motives that drive the saving behavior. He was of the view that these co-existing saving motives explain the observed heterogeneity in the household saving. "These saving motives include: old-age provision motive, precautionary motive, bequest motive and the motive of purchasing a house." (Schunk).

Sharon A. Devaney, Sophia T. Anong and Stacy E. Whirl have studied the concept of Boeree (1998, 2006) who "assumes that savings needs (and motives) can be arranged as a hierarchy...savings motives in the hierarchy are (from low to high) physiological (basic), safety, security, love/societal, esteem/luxuries, and actualization." Sharon et al. also added a "no savings" level in their study.

Hermansson (2017) has found that "Middle-aged individuals tend to have a stronger motive to save for retirement than very young or very old persons." (Hermansson, 2017)

2.2.4 Demographic Characteristics

2.2.4.1 Gender

Females have a greater tendency to save as compared to males. This is clearly evidenced by the study conducted by Somasundaramon the Savings and Investment Pattern of Salaried Class in Coimbatore District in 1999. In his findings he said that "About 60 percent of investors prefer to save first and purchase necessary household items. While 56 percent of city investors aspire so. 80 percent of female investors wish to save first as against 49 percent of male investors." (Somasundaram, 1999).

In a similar study conducted by Carsey School of Public Policy, University of New Hampshire titled "Women As Economic Providers: Dual-Earner Families Thrive As Women's Earnings Rise" it has been highlighted that "Family income is much higher in urban than in rural areas across all family types, due in part to higher personal income among women living in urban areas compared with corresponding women in rural areas."(Smith, 2015).Thus being higher earners and with the habit of saving, women became major contributors towards savings as shown by previous researches.

As opposed to this there are some researches which conclude that gender does not impact the savings and investment behaviour. No gender difference was found in the holding of stocks in the study that was conducted by Zhong and Xiao which was focused on finding the determinants of family bond and stock holdings. (Zhong and Xiao, 1995)

2.2.4.2 Age

Age is another demographic factor that affects the level of savings and investment. The study of Mangalore city's consumption and savings pattern has shown that "Age of the family head or the chief earning member is another important factor which affected savings. From the study, it is clear that majority of the households were found in the middle age group of 40-50. Negative savers were high in the age group of30-40 and 50-60. The study result corresponds with the Life-cycle Hypothesis of consumption."(Roopa, 2004).The Life Cycle Hypothesis (LCH) predicts that working population accumulate savings whiles the young and the old consume past savings.

Somasundaram (1999) has found results that are consistent with Roopa (2004). Somasundaram has declared that "a positive correlation is found between the age and the income of investors".

Singaram discusses that "percentage of net savings increases with the increase in age of the head of the households up to the age of 45 years. After that the percentage of net savings declines steadily with the increase in the age of the head of the household." (Singaram, 1998). His results also fall in line with the Life Cycle Hypothesis approach.

Chakrabarty et al (2008) in their analysis of the saving performance of Australia found that "households save more as heads become older."The findings showed that whether the head of the household is retired or not does not appear to affect savings. This evidence runs contrary to the lifecycle theory of consumption. Lifecycle theory predicts that households should start dissaving as they age.

2.2.4.3 Education

Education plays an important role in the thought process that encourages savings. Singaram has found results indicating that education increases net savings. "In the case of net savings and education of the head of the household it is found that in urban area the average net savings increases with an increase in educational level of the head of the household. In rural area the average net savings of households with heads who have formal education is only 9.7% and it is increased to 36.1% in the case of households with heads who have the collegiate level education" (Singaram, 1998)

"The study shows that, among the savers, majority are educated. Educated households saved more than the uneducated households. Thus, education and savings of the households are highly interrelated." (Roopa, 2004)

As opposed to the studies above, a study conducted by Wan et al. discusses that "Education is found to be virtually unrelated to saving." (Wan et al., 2003)

2.2.4.4 Household Size (Number of Earning Members)

"Significant correlation is found between the size of the family and the rate of savings by investors. Further, negative correlation exists between the expenses of family and the rate of savings." (Somasundaram, 1999)

Singaram (1998) discusses that "In the case of net savings and number of earning members, it is noted that both in urban and rural areas the percentage of saving increases with an increase in the number of earners of the household."

Thus a household with more number of earning members will have a positive effect on savings while a household with more dependents will have a negative effect on savings. But taking the household size as a whole, there is likely to be a negative relationship with savings.

2.2.4.5 Locality

Somasundaram (1999) in his study has found that "no significant difference is noticed between urban and rural investors in connection with rate of saving."

Similarly it has been discussed that rural households have the required desire and capacity to save where there are opportunities that encourage them to save. (Issahaku, 2011)

Choudhury U.D. (1968) focuses on the saving potential that the rural and urban households stand to have. It has been found that the rural households have a lower rate of savings rather than the urban households.

On the other hand, Chimeri (2015) in his study has found that "Collectively, urban households had more mean savings as compared to households located in the rural sector...." This was based on the fact that “Rural households in South Africa relatively save a lesser proportion of their incomes due to lower incomes in comparison to urban households who earn higher incomes."

2.2.4.6 Occupation

Savings depend largely on income as has been previously discussed and this income is generated mostly from the occupation one does. Thus a general notion that can be built is that people with higher incomes from their occupation will be able to have higher savings. On similar lines majority of the previous studies show that those within the medium to lower income group tend to have more savings account but those within the higher income group held the highest mean savings. This also stands true towards the study of Issahaku that asserts that the poor have the desire to save. (Issahaku, 2011)

Somasundaram also finds in his study that "The type of working institution also influences the rate of saving." (Somasundaram, 1999)

2.2.5 Holding Financial or Non-financial Assets

Hebbel et al. in their study on "Household Saving in Developing Countries: First Cross-Country Evidence" have found that “Monetary or financial assets also lessen a

household's dependence on current income sources when the assets to maintain their consumption levels. Hence, holding a higher stock of assets allows a household to maintain a higher consumption rate on average, thus depressing the saving rate". Thus households that hold some kind of financial or non-financial assets to support them at the time of need, tend to save less and vice-versa.

2.2.6 Expectation of future changes in income

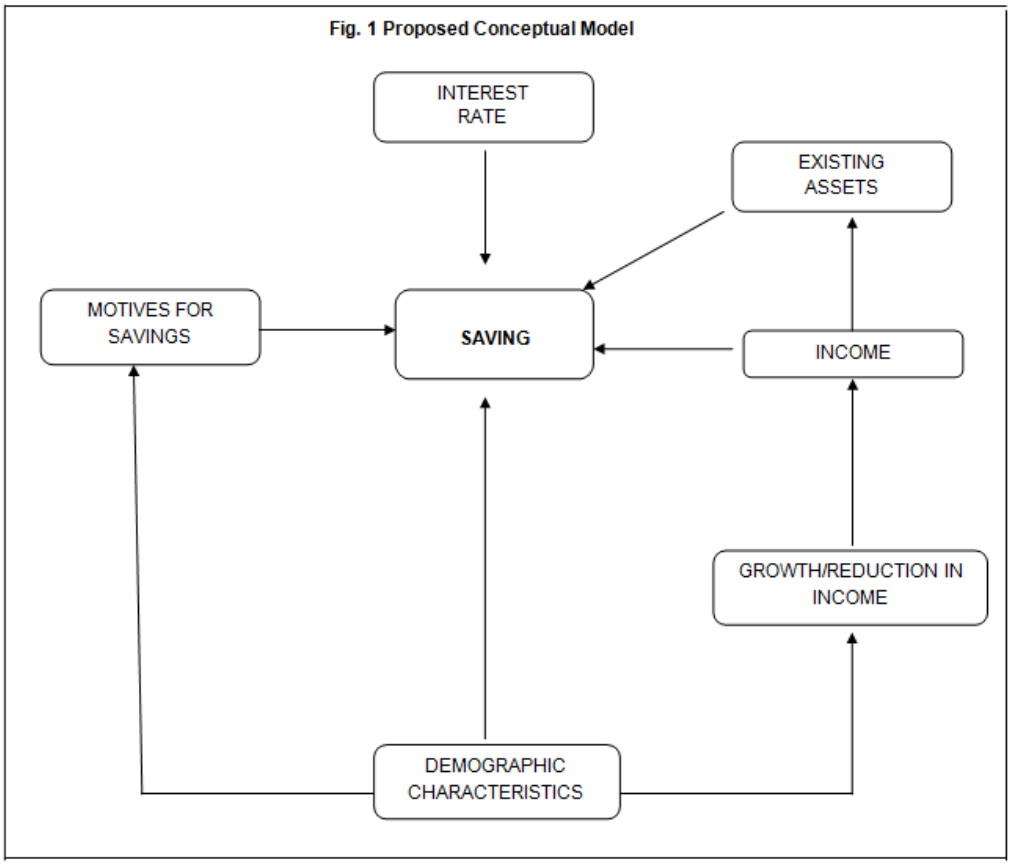
Individuals at all stages of life are faced with the challenge of uncertainty. Any expectation of such change in income in the coming future is followed by a typical reaction from the household. The level of savings is also influenced by future expectation of future increment or reduction in income. Thus if people expect future increment in their salaries or incomes, they will tend to save less but when they expect a future income declines temporarily, because consumers can draw on reduction in income, they will tend to save more to help them smoothen their consumption.

A household becomes a precautionary saver if the risk of decrease in income in the future is more. Presenting a similar view, Guariglia (2001) found a significant relationship between earnings uncertainty and saving. The results from his study implied that households save more if they expect their financial situation to deteriorate.

2.3 The conceptual model of determinants of household savings

The following conceptual model has been developed by reviewing the literature.

Fig. 1 Proposed Conceptual Model



3. Conclusion

The study conceptualized that household savings are being influenced by income and includes not only income from employment but income from all other sources including interest on securities, rents etc. The saving habits of the households are also a function of their demographic characteristics and these included gender, age, education, household size, locality, occupation. Apart from income and demographic characteristics, factors that influence the saving rate of investors includes their motives for savings, the interest rate that they will earn when they save and future expectation of increment or reduction in income. This research would help us explore the determinants that are relevant in case of our state Punjab.

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