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Financial Literacy - A Tool to Bring New Beginning in Indian Financial System

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ABSTRACT

The issue of financial wellbeing has progressively gained recognition as a vital and important life skill. Therefore, by and large the first decade of the twenty first century has seen a universal recognition for spreading financial literacy among people. Given the fact that India is having a large population, a fast growing economy with national focus on inclusive growth and an urgent need to develop a vibrant and stable financial system, it is all the more necessary to understand the importance of financial literacy in reaping rich benefits to individual, society, financial system and the nation as a whole. A financially literate and well informed public could be expected to have beneficial effects on soundness and efficiency of financial system. The present paper is an attempt to throw some light on how widespread financial literacy can significantly augment the soundness and efficiency of financial system.

Keywords: Financial Literacy, Financial System, Individual Wellbeing

I INTRODUCTION

The financial system is a set of institutional arrangement through which financial surplus is mobilized from those who have it in surplus to those who are in need of it. The financial system has three components: financial market, financial intermediaries and financial products/services.

Financial literacy is an essential life skill. Organization for Economic Co-operation and Development has defined Financial Literacy as “a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual wellbeing.”

Money management is a critical intellectual competency and an essential component of an individual's success in life. Financial literacy is a state of understanding about finance and money management. This understanding equips a person with the knowledge and skills needed to realize financial security of himself and his family and thus survive and achieve lifetime well-being. Financial literacy is the most important dimension among the determinants of human capital formation and development. Financial literacy develops an individual's ability to respond competently to life events too survive in a modern society. The common thread of financial literacy is positive financial outcomes resulting from proficient competence in key financial activities and concepts.

Financial literacy could lead to multiplier effects on the economy. A financially literate individual would resort to regular savings, which in turn would lead to investment in the right channels and income generation. The financial well being of individuals will in turn increase the welfare of the

society and pink health of the Indian financial system.

MasterCard is an American multinational financial services company. Financial Literacy Index (2014) has been created by MasterCard based on a survey conducted between July 2014 and August 2014 on 8,087 respondents. This survey on financial literacy was conducted for the 4th time in 16 countries across Asia Pacific region. The respondents aged between 18 – 64 years. The purpose of the survey was to gather more insight of each country's current financial literacy, the progress each country has made since the previous survey, and how each country fares relative to its peers. India is at the 12th position among the 16 countries chosen for the survey.

Table 1
MasterCard Financial Literacy Index (2014)

Rank	Country	Financial Literacy Index
1	Taiwan	73
2	New Zealand	71
3	Hong Kong	70
4	Australia	69
5	Malaysia	69
6	Singapore	68
7	Thailand	67
8	Philippines	66
9	Myanmar	66
10	China	65
11	Vietnam	65
12	India	62
13	Korea	62
14	Indonesia	61
15	Bangladesh	60
16	Japan	55

Source: <http://www.mastercard.com>

From the above table 1 it is evident that our situation is not satisfactory as compared to other Asia Pacific countries. The direct repercussion of low financial literacy is an unhealthy financial system which in turn will erode India's growth potential. Increasing access to financial system should be a priority for making growth more balanced and sustainable from both economic and social perspectives.

Deeper participation in the financial system could be achieved only through widespread financial literacy.

II REVIEW OF LITERATURE

- (a) The objective of the study was to sketch an average cognitive map and to find the factors and explain the reasons which lead to failure of the Tunisian small investors in the stock market. The authors had experimented 128 individuals who actively traded in the Tunisian stock market. The results of the study insisted on the importance of financial education and the investor behavior in the success of stock market participation.
- (b) The paper contrasts the prevailing individualistic approach of financial literacy measurement and financial education with an educational framework that seeks to equip young people to play an active democratic role and to develop a broader understanding of the financial world. In particular, the framework suggested how important dimensions of financial literacy may be addressed in terms of the individual, the financial industry and government.
- (c) The researcher had investigated financial literacy and particularly understandings of risk i.e. risk literacy. The researcher had used numerous sources of data to describe the level of financial literacy among the population of United States and other countries. The data was used from the surveys conducted in the United States and other countries. The study demonstrated that across countries, risk literacy is very low and a large chunk of population lack comprehension of concepts such as risk diversification and the relationship between risk and return. Moreover, the study has shown that a substantial proportion of individuals did not have an understanding of the fundamental concepts like basic numeracy and information of inflation. The researcher adds that these findings are bothersome. The researcher suggested that risk literacy is very important because financial and saving decisions are essentially about risk and management of risk and those who are more knowledgeable about risk are more likely to

have savings for rainy days and will be able to plan better for their retirement. Addressing lack of financial literacy, including risk literacy will provide new ways and means to encourage savings and financial security.

III OBJECTIVES

The paper is made with the objective to highlight how financial literacy is important in influencing individual's decisions to save, borrow, invest and manage their financial affairs which affects their capacity to grow their income and wealth and in turn also has significant implications for the potential growth rate and health of the Indian financial system.

IV RESEARCH METHODOLOGY

Research is a scientific and systematic search for knowledge. It is an original contribution to the existing literature on a specific topic. "Research methodology is a way to systematically solve the research problem." [4]. Therefore, the methodology designed for this particular research paper is as follows:

Research design is a blueprint or detailed plan of what information is to be collected from which sources and by what procedures. It is the overall operational pattern or outline or framework for how a research study is to be completed. It is the conceptual structure so created so as to obtain answers to research questions and research problems. "Formulation of the research design is not a stagnant stage in the research process rather it is an ongoing backward and forward integrated process by itself"[5]. The design of the research paper is descriptive.

"The task of data collection begins after a research problem has been defined and research design chalked out." [4] "Secondary data as the name implies is that information which is not topical or research specific and has been collected and compiled by some other researcher or investigative body. The said information is recorded and published in a structured format and thus is quicker to access and manage." [5] Secondary data is used in this particular research paper and the sources are Magazines, Journals, Research Papers, Newspapers, Websites, Newsletters, Monthly bulletins (Reserve Bank of India, Securities Exchange Board of India), Data Published by RBI, NSSO, IBA and NIBM.

V FINANCIAL LITERACY FOR SOUND FINANCIAL SYSTEM

A financially literate and well informed public have beneficial effects on soundness and efficiency of financial system. Therefore, following reasons explain the need and importance of financial literacy:

(a) Economic Depression or Financial Crisis-

One of the grounds for the relevance of financial literacy is the austerity of the economic downturn in almost all the nations in the last decade and the extent to which it had an effect in all walks of life of the people and at all levels of economic well-being. Financial crisis of 2007-08 was the repercussions of lack of understanding of mortgage products and the subsequent defaults. This economic crisis captured everyone's attention and because the negative impacts were so widespread and indiscriminate in terms of who was affected that almost all countries have now taken more interest in financial literacy and financial capability and are extra concerned in propagating the importance of financial education.

(b) Financial Literacy: The Demand Side of Financial Inclusion- Financial inclusion is one of the top most policy priorities of the Government of India. Financial inclusion broadens the resource base of the financial system by developing a culture of savings among large segment of rural population and plays its own role in the process of economic growth and economic development. The two pillars of economic growth of a country are financial literacy and financial inclusion and these two strategies promote greater financial stability. While financial literacy creates demand or feeds the demand side by promoting awareness among the people regarding the needs and benefits of financial services offered by banks and other financial institutions, financial inclusion works from supply side by providing access to various financial products/services. In our country too, only endowing with financial products and services to the people of rural or semi-urban areas is not sufficient; people need to be made well informed in terms of fundamental financial products, knowledge of financial markets, benefits of availing financial services etc because the concept of financial inclusion calls for financially literate people so that they can take the best advantage of inclusion plans.

(c) Reduces Reliance on Foreign Capital- Dependence on foreign capital certainly leaves an economy at the mercy of the whims of foreign investors. A more financially literate

population is expected to increase domestic savings rates thereby dipping reliance on foreign capital. Higher and better allocated savings can upshot faster economic growth.

(d) Corporate Scams and Financial Frauds- In the last decade the proliferation of financial frauds and big corporate scams like Ketan Parekh Securities scam (2001), Home Trade scam (2002), Satyam Computers scam (2009), Speak Asia scam (2011), Saradha chit fund scam (2013) etc. has emanated to the increased interest in financial literacy. Therefore, people need financial literacy to understand and avoid the frauds and scams that may encounter in their lives. Financial literacy is also required for sustaining the confidence of investors in financial markets.

(e) A Tool for Investor's Protection- Financial literacy acts as a tool for investor protection. Making people literate about the existence of an effective grievance redressal mechanism is essential for gaining the confidence and overcoming the apprehensions which people may have about securities market.

(f) Financial Literacy leads to better Understanding of Government's Financial Policy and Welfare or Social Security Programs. There is a need to ensure the success and impact of government's financial policy initiatives but this can be assured only if the policies and programs are better understood by those for whom they are targeted. Enhanced financial literacy/education contributes to improved success of governmental programs.

(g) Deeper Participation in Financial Markets- In India we need to convert savers into investors. Savings and investments have been considered as two critical macro-economic variables with microeconomic foundations for achieving price stability and promoting employment opportunities thereby contributing to sustainable economic growth. More participation of domestic retail investors in securities market will give dividends by increasing depth of securities market, reducing dependence on foreign investors and domestic savers reaping benefits of corporate growth and reducing strain on government treasury for investment in national infrastructure.

(h) Financial Literacy is even needed for Financial Product/Service Providers- It is not only the consumers of financial products or services for whom financial literacy is necessary but it is also a prerequisite for providers of financial services. Financial literacy for financial service providers involves understanding and designing such financial products which satisfy the needs of even those investors who have different appetite for risk.

Thus, it can be concluded that financial service providers will help in expanding the financial system of the country, not through cheating their investors by promising higher returns from their products but by responding innovatively to consumer demand, leading to a more dynamically efficient financial system.

(i) Changing Environment and Market Innovations-

Today, the way we shop has changed a lot. Online shopping has become the top choice of many young shoppers, creating opportunities to use and over extend credit, an all too easy way to accumulate debt, fast. Many of these consumers have very little understanding of finances, how credit works and its potential impact on their financial well-being for many, many years. Therefore, financial literacy is required to develop skill, knowledge and confidence to manage debt which would enable them to have more control of their present and future circumstances. Development in technology has transformed every aspect of processing, marketing and delivery of financial products and services. The use of Internet as a means of communication and delivery of financial services and products in an efficient manner is a boon for financial services providers and it has also removed the limitation of geographical boundaries for consumers. These technological advances and market innovations ask for the individuals to be financially literate so that they will not only identify appropriate providers and delivery channels from the vast array of possibilities but also to use these innovations for saving time and to make the financial transactions speedier.

(j) Freedom from Exploitation- A more financially literate society will exert stronger market disciplines on financial service providers which will protect individuals and society against exploitative financial schemes and exorbitant interest rates charged by money lenders. Stronger market disciplines are also likely to encourage a higher standard of financial service delivery.

VI CONCLUSION

The paper has summarizes significance of financial literacy at various levels. Improved financial literacy can benefit individuals and families by enhancing their money management skills and giving them more control over their money thereby helping them in making better financial decisions. Thus, financial literacy is an essential element in enabling people to manage their financial affairs, thereby making an important contribution to the soundness and efficiency of the financial system and to the performance of the economy.

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