Managing Demand for products in India: Role of Financial Literacy

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Meaningful Inclusive Growth is today's buzzword. This can be achieved through investments by all including lower part of the pyramid into sectors like agriculture, health, education and housing. Such investment requires knowledge about different financial products available. Supply side talks about access, availability, affordability and transparency of such financial products. However the demand side talks about behavioral change required to access such products and thus highlight the importance of Financial Literacy. Aim of the paper is to develop theoretical model based on exhaustive literature review to investigate the role of Financial Literacy in managing the demand for financial products.

Key words: Financial Literacy, Customer protection, Inclusive growth, Demand for Financial products

1. Introduction

The term 'Inclusive growth' as defined by Planning Commission of India is 'a process of including the excluded as agents whose participation is essential in the very design of the development process and not simply as welfare targets of development programmes.' It is about having economic growth with equality of opportunity to all. However, in India what we see is 'Rich is becoming more richer while, poor is becoming more poorer.' Rather it can be seen that rich is becoming faster richer and poorer is becoming faster poor. Inclusive growth talks about minimizing these inequalities by eliminating issues of exclusion. The suggested key areas for policy intervention for Inclusive growth are improving earning opportunities by creating employment, improving access to such earning opportunities, having access to basic health care, basic education, improving productivity of farm and non-farm activities, increasing entrepreneurial activities so on and so forth. To summarize, Inclusive growth calls for investment or involvement of finance Levin (2012); in major sectors like agriculture, health, education and housing. And such investment requires knowledge about different financial products available in the financial market. In recent times, the need of financial security among individuals has increased (Hilgert et al.2003) at the same time financial markets have become more complex due to the nature and availability of variety of financial products and services. Therefore, the term 'Financial Literacy' has gained much importance. Financial literacy helps to create knowledge; awareness about different financial products available as well helps to have tradeoff between risk and return from these products for better returns.

Economical, Political, Social and Financial systems of a country define its parameters of Inclusive growth. Financial system of a country asks for financial stability. Financial stability helps to limit imbalances in the economy as well helps to avoid crisis. This financial stability is characterized by Financial inclusion along with Financial literacy and customer protection. While the importance of Financial inclusion is widely recognized, it should be understood that process of financial inclusion is a complex process. It has Supply as well Demand side. Supply side says, Financial inclusion is not just about access to financial products, it is also about timely availability of these products at affordable cost in the customized way in fair & transparent manner by mainstream institutional players to the one who are in need of it. Financial inclusion looks at expanding the bounded space for those who were earlier outside this space i.e. 'Creating Awareness' about availably financial products & services to the ones who are excluded from the financial system. The institutional players, policy makers are making enormous efforts on the supply side of financial inclusion by adopting different ways to ensure delivery of financial products and services. However statistics says that Out of over 600,000 rural habitations in the country, only about 30,000 or just 5% have a commercial bank branch. Just about 40 per cent of the population across the country has bank accounts and this ratio is much lower in the north-eastern part of the country. The proportion of people having any kind of life insurance cover is as low as 10 per cent, and the proportion having non-life insurance is only 0.6 per cent. People having debit cards comprise only 13 per cent and those having credit cards a marginal 2 per cent. Across India, less than 10% of the 'no frill accounts' are active. Thus, what is needed is push from Demand side to have meaningful Financial inclusion through financial literacy. Financial literacy is an important instrument in creating demand for financial products. It is considered to be an important pillar of financial stability of a country.

2. Literature Review

Review of Literature throws light on various aspects of financial literacy while defining it. However, all of them implies Financial literacy develops individual's capabilities to use financial products and services. It helps to increase awareness, gain knowledge and develop required skills and finally bring change in the behavior to understand the nature of financial products and services available and their need.

Lusardi et al.(2011) identifies Financial literacy is about having knowledge of the different concepts being used in complex financial markets to take financial decisions with respect to investments in different stocks to have wealth maximization. Remund (2010) argues based on literature review the definitions of financial literacy can be classified into two distinct sections: Conceptual definitions & Operational definitions. Conceptual definitions explain abstract concepts in concrete term whereas Operational convert these concrete terms into measureable criteria's. Various Conceptual definitions of financial literacy fall into five categories: Knowledge of financial concepts, ability to communicate about financial concepts, ability to manage personal finance, skills in making appropriate financial decisions, confidence to plan effectively for future financial decisions. Operational definitions help to measure abstract concept. These definitions are fall into four categories: Budgeting, Saving, Borrowing & Investing. According to him financial literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being. According to Huston, S. J. (2010) financial literacy is an important input to the process of creating financial education and also an important tool to understand the variations in financial outcome which is one of the important output of this process. Financial literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being. Mitchelli (2007) theorizes Financial literacy is about people remaining well informed about basic economic & financial concepts needed to make saving, investment, retirement planning, mortgages & other decisions.

Several studies have placed emphasis on the importance of financial literacy and basic financial concepts saying illiteracy often leads to incorrect financial decisions, poor retirement planning, poor borrowing, less participation in financial markets Lusardi, A. (2008).

Lizard and Mitchell (2011) argue financial literacy is also important in planning for retirement. Van Roil et al. (2011) says basic knowledge about various financial concepts is important to deals in stocks in financial market. Lack of certain aspect of financial literacy lead to 2008 global financial crisis (Gerardo et al. 2010). In our day to day life we see plenty of examples of individuals suffering on account of lack of adequate financial knowledge. There are many who borrow credit cards (Warwick and Mansfield 2000), housing loans, car loans, and educational loans without understanding the structure of loan repayment and then are caught in the vicisous circle of penalties, hidden fees. India is an agrarian economy with around 60% of its people depending directly or indirectly upon agriculture. According to ADIS 2012 Annual Report farmer suicides account for 11.2% of all suicides in India. Indira Gandhi Institute of Development Research in Mumbai did field research and found the top causes of farmers suicides to be: debt, low income and crop failure, family issues such as illness and inability to pay celebration expenses for daughter's marriage, lack of secondary income occupations and lack of value-added opportunities. Chen and Volpe (1998) financially literate individuals are more likely to engage in sound financial planning early in their lives on the other part inadequate knowledge will limit their ability to take informed financial decisions. Lusardi and Mitchell (2007) argue financial planning has direct relationship with wealth accumulation. Financial planning behavior is the result of financial literacy. Planning behavior changes from person to person that is why housing wealth differ. Those with low education are at the risk of not preparing for their retirement.

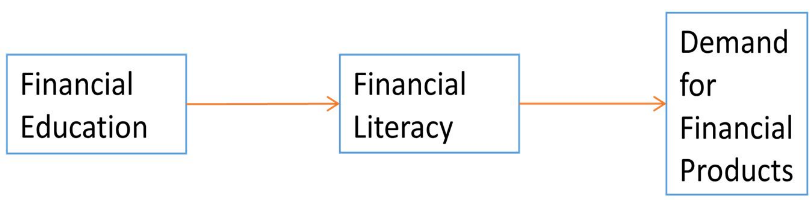
Financial literacy also helps to understand the taxpayers about the deductions available and help to reduce taxes through Tax Avoidance techniques.

According to Lusardi et al (2010) financial literacy is strongly related to family background and peer effect. Financial literacy is the phenomenon through which this awareness can be created among investors to improve their understanding of financial products, markets, concepts and risks. Financial literacy is all about how I manage my money? Financial literacy mainly aims at individual wellbeing.

3. Theoretical Framework

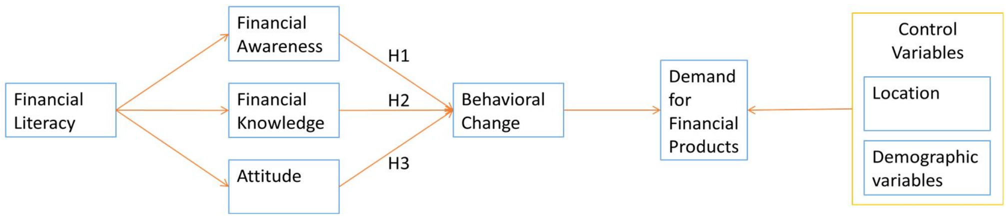
While there is rich body of literature available which talks about importance of financial literacy and Financial education research on behavioral change required is scant. Financial Education is a very broader concept. It is a process which talks about creating financial awareness, financial knowledge & financial attitude to reach desired level of financial literacy (Hung et al. 2009). Financial literacy is the ability to use knowledge and awareness. However above all of this what is required is change in the behavior to bring meaningful level of financial literacy. In spite of various initiatives by RBI towards increasing financial literacy challenges are faced in promoting financial literacy in India.

While it is reasonable to assume that Financial education by attempting a level of Financial literacy brings required behavioral change, still the question mark exists on account of causal relationship between Financial literacy, education and required behavioral change to create demand for financial products. Hence we develop a theoretical model which integrates financial education with financial literacy .subsequent section develops a research model based on this framework and defines hypothesis.



4. Research Model and Hypotheses

Bases on the theoretical proposition Financial education leads to financial literacy and finally creates demand for financial products a research model is created.



4.1 Financial Awareness and Demand for Financial Products

Many of the programs by mainstream institutional players focus on creating awareness but it does not merely add up to the financial practices what is required is behavioral change . Extant literature is not clear about how behavioral change mediates the impact of financial awareness on creating demand for financial products. Hence it’s proposed that,

Hypothesis 1: Degree of Financial awareness leads required behavioral change required to create demand for financial products.

4.2 Financial knowledge and Demand for Financial Products

Financial knowledge have been shown to be significant in creating impact on behavioral change. Borden et al (2008) argues that financial education programs definitely improves financial knowledge of college students and builds a level of financial responsibility in them. Financial knowledge is appropriate catalyst to foster behavioral change. Lyons et al. theorizes (2006) individuals ability to save, control and invest partly depend upon his or her financial knowledge. Perry et al. (2005) argues financial literacy programs do affect financial knowledge of poor segment of people and leads to actions of their well being. Thus it is suggested that,

Hypothesis 2: Financial knowledge leads to required behavioral change required to create demand for financial products.

4.3 Attitude and Demand for Financial Products

Literature supports the fact that attitude influence beliefs as well behavior of individuals. Attitude is an expression of favor or disfavor to a person, event, thing. The literature which supports the assumption that attitude through financial literacy impacts demand for financial products is limited. Thus,

Hypothesis 3: Attitude leads to required behavioral change required to create demand for financial products.

To account for the difference in demand for financial products, control variables like location, demographic features of individuals are included as control variables. These variables are selected on the basis of extant literature review.

5. Conclusion

To conclude it can be said that financial literacy among people is very less. Due to lack of financial literacy, people are not able to take good financial decisions. The more literate a consumer is, the more likely they are to possess a good financial decision making skills. At the same time it is also seen that imparting only financial literacy programs is not enough. There is a need to understand that the key is having behavioral change among individuals which creates an urge for demanding financial products. Basically the ‘Basic need approach’ needs to be extended to include financial education along with current triad of food, clothing and shelter. Doing this will definitely lead to the behavioral change required to get the desired level of financial transactions in the country and in real terms, inclusive financial growth.

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