

Market Assessment of Financial Literacy in India

Abstract: *The standard of financial literacy in the Indian retail investor base is one important determinant of the financial behaviour and financial preferences of retail finance customers. In this brief we discuss a possible approach for considering this issue and present some of the headline findings from the Invest India Income and Savings Survey 2007 on a variety of financial literacy indicators that were measured in the survey.*

There has been very little informed debate or understanding of financial literacy as a determining factor in the disposition of household investment behaviour in India. However, financial literacy is a hugely significant issue for finance markets as it both drives and distorts investment behaviour and the composition and direction of demand for the products of competing financial sector interests.

Despite the proliferation in the range of financial products available, it seems that small investors continue to be more attracted to gold and property investments and lower yielding traditional financial products. Moreover, the average Indian's investment horizon remains short-term with an apparent reluctance to participate in longer-term savings instruments that do not have as a feature unsustainable interest rate subsidies paid from Government coffers. Notwithstanding the relative attractions of life insurance savings plans in India, IIMS Dataworks estimates that in 2007 less than 20 percent of aggregate savings made by active members of the Indian workforce were directed into long-term savings products.

The financial literacy debate in India often stumbles at the first hurdle which is to arrive at a consensus on what should be the terms of the debate. Part of the reason for this is the differing agendas of self-interest among financial market segments. For example, the incipient financial planning industry in India argues that literacy is a structural problem in terms of the lack of a normative financial planning mentality in the investor base. Others argue that a cohesive public education program is required for this purpose, and investment in financial literacy outcomes in school curriculums in particular is required. Market linked investment product providers, such as mutual funds, on the other hand often conceptualise financial literacy in

terms of engendering greater understanding among investors in issues such as the risks and returns equation and the time value of money. And both parties are correct to think in these ways as ISSS data show that fewer than 2 percent of those with cash incomes take formal savings and investment advice and over 50 percent of those with savings not registering price inflation as an important factor in investment decision making. These issues however are only part of a larger mosaic of problems.

A now widely accepted definition of financial literacy internationally is one formulated originally by the U.K. National Foundation for Education Research which describes financial literacy as "the ability to make informed judgments and to take effective decisions regarding the use and management of money". The utility of this definition is that it successfully conceptualises the issue without overlaying value judgments concerned with particular financial market segments or particular financial product classes, socio-economic or cultural factors. By firmly placing the horse before the cart it also provides a solid foundation for considering the full logistics required for a successful journey forward.

With this definition as a starting point, the degree to which financial literacy exists in a particular locality has as its yardstick the extent of the mismatch between the actual financial behaviour of individuals and their actual capabilities, needs and savings goals. For example, for a day labourer in India with modest financial resources financial literacy could be said to exist if individuals have the ability to make informed judgments and take effective decisions regarding issues such as household budgeting, small savings schemes and access to basic credit facilities and insurance products. Knowledge of equity markets, or a willingness to invest in mutual

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funds would not be a criterion of financial literacy for such people. For middle and higher income earners with the opportunity to build wealth and financial security for themselves and their families, greater sophistication obviously is required. In other words, financial literacy is multifaceted and varies according to the myriad circumstances and financial capabilities of investors.

Adaptation of the definition in a particular country's case of course is necessary to bring context, and in India's case the task of doing so has yet to be undertaken in any structured way. To illustrate, the Australian Securities and Investments Commission has identified four generic markers of financial literacy in the Australian context. These are:

- The ability of individuals to budget appropriately;
- The ability of individuals to identify financial products and services that meet their needs;
- The ability to locate reliable and independent financial advice; and
- The ability to avoid falling victim to abusive practices and scams.

What is immediately striking in the Australian adaptation is the degree of congruence with India's own situation. Moreover, surveys of financial literacy in Australia¹ demonstrate that mismatches between financial needs and financial behaviour are most likely to occur for individuals with educational attainment below higher secondary, unskilled workers, persons with low incomes and savings levels and younger (aged 18 to 24 years) and older people (aged 70 years and over). Similar surveys² in other mature market economies such as the USA and the UK have yielded similar results.

Low levels of financial literacy therefore are not a problem that is unique to India, and from the experiences in other countries nor can it be assumed that achieving developed economy status in the future will remove the problem. Rather, a pro active approach is required.

The keystone of financial literacy is a perception that disciplined saving is important. Unwillingness on the part of individuals to save is the most adverse of financial literacy markers. IIMS Dataworks 2007 Income and Savings Survey data show that among India's 321 million paid workers 59 percent do not make regular savings in formal financial instruments, gold and property investments and a snapshot of the characteristics of this group appears in Table 1. Of those who do save regularly, IISS 2007 data show that some 72 percent save at least 10% of their incomes on an annual basis. What is more remarkable is that savers with very modest incomes (< Rs. 25,000) manage to put aside at least 10 percent of their incomes with 75 percent managing to do so.

So the perception that Indians are good savers, while certainly correct, often fails to register the equally important fact that most do not have a regular savings habit, which in terms of financial literacy standards is alarming. This is of even greater concern considering that only a minority of Indians is covered by mandated, and/or government financed social security schemes and social safety nets. To the extent that the situation is somewhat better than the IISS data suggests in that a number of people do not direct their savings into formal financial products, preferring to keep their savings at home in cash, the financial literacy implications are even more adverse as the real value of such savings is quickly eroded.

Table 1 : Selected Characteristics of Those Who Do Not Save Regularly

Nearly 80%	Live in rural areas
Over 90%	have incomes below Rs.50,000
Nearly 53%	are wage labourers
Nearly 23%	are farmers
Over 90%	have at least 3 other persons dependent on their incomes
Over 40%	Live in joint/ extended households

The data also demonstrate that there is a strong correlation between the propensity to save and income, with the propensity to save rising from 34 percent of earners with annual incomes below Rs. 25,000 to 84 percent for those with annual incomes in excess of Rs. 150,000. Therefore, while admittedly at a dramatically different incidence, there is an issue to be addressed for higher income individuals as well as those with more modest incomes when it comes to who does and does not have the regular savings habit.

The flip side of savings rates is that the Indians generally are cautious borrowers and most have negligible debt portfolios. However, the signs are present that things are changing with the growth in retail credit through the banking sector and the escalation of residential housing prices in many locations that will necessitate many more people taking loans to finance their housing needs. The ability of the growing middle income classes in particular to effectively source appropriate credit to meet borrowing needs for these and other purposes therefore should be seen as an urgent and important financial literacy issue that will grow in significance into the future. This observation is underscored by the fact that at the present time paid members of the workforce continue to access credit from moneylenders in significant numbers irrespective of their level of income. In 2006/2007 for example, some 6% of indebted urban workers and some 16% of indebted rural workers with annual incomes in excess of Rs. 120,000 had debts with moneylenders.

¹ National Survey of Adult Financial Literacy in Australia, 2002.

² Comparable surveys with comparable results have been conducted in the U.K. (see Financial Literacy in Adult Life: Research Summary, National Foundation for education Research, 1996 and Summing Up: Bridging the Financial Literacy Divide, National Association of Citizens Advice Bureaux, November 2001)

The ability of individuals at the present time to identify financial products and services that meet their needs also provides a salutary picture. Despite its long standing availability in Indian financial markets, over 47 percent of paid workers have never bought life insurance products. Moreover, for those who do buy, only a small minority (8 percent) do so as part of a retirement savings plan and over one third take up insurance savings plans as an investment and not a contingency management tool. In other words, most purchasers of life insurance at the present time are misconceiving the primary nature and central utility of the product. A further example is that only some 10 percent of those who had invested in the Public Provident Fund in the past nominated their savings objective as being retirement income needs.

Similarly, only a negligible number of paid workers have shown interest in general and health insurances (<2 percent). The obvious vulnerabilities that this occasions for most individuals therefore clearly are not front of mind for the overwhelming majority of people indicating a fundamental lack of financial literacy skills in terms of contingency management.

These vulnerability levels are both high and alarming and a primary objective of promoting financial literacy in the country should be to find affordable and accessible mechanisms for remedying this situation. How that might be achieved is worthy of greater attention by financial product providers themselves and should not be seen as a problem that Government alone should tackle. In fact, in the immediate term, the finance industry will need to take the lead if quick progress is to be achieved. The incentive for financial institutions thinking in this way is that progress will bring with it a greater volume of business.

Given the prominence of agent workforces in retail finance sales, both individual firms and the finance industry at large, including financial regulators, would be well advised to revisit agent training and certification processes to promote greater financial literacy among the agents themselves. This would involve instilling in agents an appreciation of basic financial planning principles and tailoring agent training programs to position agents to understand the relative benefits of the products they sell compared to those offered by competing market segments. Properly designed, such training would add to the armory of sales strategies from the agent's perspective and as a consequence it could be expected that agents would embrace that knowledge as commercially useful. In the process financial firms would reap the benefits of higher sales volumes also. The fact that many agents would be likely to employ that knowledge in a self-interested way to the detriment of competing product lines should not be seen as a disadvantage, as agents approaching the sales task in this manner would in the process necessarily bring to the customer's attention a range of relevant issues consistent with raising investor literacy levels.