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Financial Capability- A New Paradigm of Financial Literacy

D V Deshpande¹ and Anshu Singh²

ABSTRACT

Financial literacy is one of the key drivers of financial inclusion in the country, which in turn is an important component of Sustainable Development Goals (SDGs). Although, several efforts have been made in the country with regards to Financial Literacy and Financial Inclusion, there is a concern that they have not given results to the desired extent. This is evident in terms of large number of dormant bank accounts and existence of sizeable informal borrowings.

The authors have put forth in the paper that there is a need to take a paradigm shift from the traditional models of Financial Literacy to a relatively new concept called “Financial Capability” to deliver the desired results. This concept of “Financial Capability” encompasses dimensions of financial knowledge, skill, attitude and behaviour to take good financial decisions by one and all. The authors feel that graduating from “Financial Literacy” to “Financial Capability” will lead to achievement of demand driven financial inclusion rather than supply driven. Several suggestions have been made in this direction in the paper.

Key Words: Financial Inclusion, Financial Literacy, Financial Capability, SDGs, PMJDY, RBI, NABARD, FLCC, FLC, OECD, INFE, FINDEX, WORLD BANK

1 Background

There is a well-recognized perception among policy makers, financial institutions, civil society organizations and other key stakeholders that financial inclusion models can support overall economic growth and the achievement of broader development goals. It is well documented that Financial Inclusion is a key enabler of eight Sustainable Development Goals (SDGs). It’s not a goal in itself but a means to an end as a continuous journey towards economic prosperity and equality.

To achieve the goals of financial inclusion, several countries have embarked upon an ambitious mission by building a national strategy on Financial Inclusion. In 2012, G20 leaders endorsed the high-level Principles on National Strategies for Financial Education developed by the Organisation for Economic Cooperation and Development (OECD); International Network on Financial Education (OECD/INFE). These principles indicated that assessing the financial literacy competencies of the population is a key component of a successful national strategy. As a follow up to that, many countries like China, Brazil, Korea, Indonesia, Portugal, Belgium etc., have formulated a National Strategy on Financial Education. By 2015, Fifty Nine countries have reported on developing a national strategy, implementing one; revising it and developing a new one, with an additional five, planning one. This represents a steady increase when compared with the situation in 2011, when 26 countries reported having developed or implemented a national strategy (more than 200% in three years). This was imperative because education and literacy was considered as a major driver of financial inclusion from the demand side, as indicated in the National Strategies for Financial Education: OECD/INFE Policy Handbook.¹

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India, too has formulated a National Strategy on Financial Education in 2012. The Government of India, Reserve Bank of India (RBI), National Bank for Agriculture and Rural Development (NABARD), Insurance Regulatory and Development Authority (IRDA) and Securities Exchange Board of India (SEBI), etc., have taken path breaking initiatives for financial inclusion and financial literacy/education. This has resulted in the concrete outcome of large number of hitherto excluded people (generally poor) to get access to proper bank accounts; the number of ‘zero balance’ accounts under Pradhan Mantri Jan Dhan Yojana (PMJDY) at over 30 Crore has set a Guinness Book of World Record! Such a massive financial inclusion programme is first of its kind and the quick results achieved in terms of access points in the form of bank accounts are commendable. However, that itself is not the objective of this massive effort. The outcome expected is much more robust – in the form of substantial savings and sustainable livelihoods for the most vulnerable and excluded million.²

But the evidence is suggesting otherwise. The World Bank Group’s Global Findex Database reports that almost half the new bank accounts were inactive in the last 12 months. Globally, about 20% of account owners report an inactive account (i.e. without a single deposit or withdrawal in the past 12 months). At 48%, India has the highest rate of inactive accounts in the world, and about twice the average of 25% for developing economies. Even the accounts that are active are scarcely used, with a high reliance on cash transactions. The number of inactive/dormant accounts continues to be high which is an indication that still the poor and excluded people do not appreciate the virtues of saving in a bank account.³

2 Problem Statement

This brings to the table, a revelation that merely opening an account as a result of financial inclusion campaign is not sufficient as these measures have provided the ‘access’ but have not ensured ‘usage’ of financial services.

Many efforts have been put to address demand side barriers also like lack of financial literacy. However, the traditional methods of financial education and literacy have not shown substantial impact. It would not be wrong to say that Financial Inclusion in India has always been a push phenomenon (supply driven) rather than pull phenomenon (demand driven). Though many efforts have been put to reduce some

In the country several policy initiatives and schematic interventions from supply side were taken by the Government namely; The Cooperative Movement, Priority Sector Lending, Lead Bank Scheme, Service Area Approach, Creation of National Bank for Agriculture and Rural development (NABARD), Introduction of Regional Rural Banks/ Local Area Banks, microfinance, Kisan Credit Cards (KCC), Business Correspondent/ Business Facilitator (BC/BF) and finally, Pradhan Mantri Jan-Dhan Yojana (PMJDY).⁴

It is felt that the ultimate goals of Financial Inclusion can be achieved only when the poor have sustainable livelihoods that enables them with a source of income so that, they may demand financial services / products and use them actively. Only then will a bank account seem relevant to them and they shall be motivated to use it in the best of their financial interests. To understand demand driven aspects of Financial Inclusion, there is a need to get into a new paradigm of ‘Financial Capability’

¹(OECD, 2015)

²(India Today, 2015)

³(Source : World Bank Global FINDEX Report, 2017)

3. Research Objectives

The authors follow an exploratory approach to the study by undertaking a critical review of the existing efforts of financial literacy in the light of financial inclusion outcomes. In this regard three objectives are proposed to be achieved.

- i. To examine the financial capability framework and identify actionable weak areas of capability in the context of financial inclusion
- ii. To critically review the efforts and measurement of financial literacy in India
- iii. To propose a paradigm shift from Financial Literacy to Financial Capability to address demand side barriers of Financial Inclusion

4. Financial capability

4.1 The Capability Approach

The Oxford Dictionary defines *capability* as “*The power or ability to do something.*” The basic understanding about the word capability is the extent of ability of any entity to act and take decisions in the best of one’s interest.

One of the most celebrated Indian Economist and Philosopher, Amartya Sen in the 1980s, first articulated the “*Capability Approach*” to *Development and Poverty*. He further propounded that *poverty is not just deprivation of necessities but also depreciation of capabilities*. The capability approach permeates beyond the notional boundaries of availability of commodities and holds the view that *Poverty is a situation where people lack the most basic capabilities to lead a good life*.

People may be deprived of in several ways, for example: lack of education and understanding, ill health, oppressive state policies, lack of financial resources, inability to absorb sudden shocks, socio-psychological barriers, gender inequality, social exclusion, fear of action etc. The capability approach can be understood well by a simple example. Let us suppose that a country is very rich in natural resources or may have good per capita income in conventional economic terms (i.e., in terms of the value of commodities produced per capita) and still be poor when it comes to achieving good quality of life for its citizens. (Nigeria & Venezuela)

4.2 Financial Capability – Concept & Definition

If the above capability approach is understood in the context of Financial Well-being, we may say that mere access to financial resources, services and products may not lead to financial well-being and prosperity. Therefore, there is a need to define and understand Financial Capability which if ensured, will enhance the financial wellbeing of people. A brief reading into the literature gives us the most acceptable definition of Financial Capability. *According to World Bank, Financial capability is the internal capacity to act in one’s best financial interest, given socioeconomic and environmental conditions. It encompasses the knowledge (literacy), attitudes, skills, and behavior of consumers with respect to understanding, selecting and using financial services, and the ability to access financial services that fit their needs.*⁵

⁴ Retrieved from <https://www.thehindubusinessline.com/opinion/financial-inclusion-is-fast-losing-steam/article26071996.ece> (*The Hindu Business Line*, 2019)

Today, Financial Capability has attracted lot of interest of Policy Makers from across the world in both high income and emerging economies. Studies are being conducted in the area of measuring financial capability by World Bank, OECD INFE, Academic Institutions and Universities abroad, to guide policy makers and financial services providers to roll out more specific programs, policies and products targeted to specific problem areas. Several countries like Morocco, Philippines, Kenya, Canada, New Zealand etc., are working on measuring financial capabilities and using survey insights to design policies and programmes.

The financial landscape of India is changing at a dynamic pace and in such a scenario a single one-shot solution will not work for all problems of financial inclusion. For instance, two individuals might have the same level of awareness and literacy with regards to a financial inclusion scheme. However, they will differ in their abilities to use that scheme to their advantage. Further, let's also assume that they have similar abilities too, but still their socio psychological makeup and behaviours may further define their capability of availing the benefits of the scheme.

So, there is a greater need to delve deeper into behavioural aspects which shape up the ability of a person to use financial products and services. Such careful behavioral analysis will help in developing targeted interventions for specific group of people, to increase uptake of financial services and further boost the already ongoing efforts of financial inclusion.

The core idea of Financial Capability is that there is a need to address the pain points and the need for demand driven services, rather than offer a generalized bouquet of services.¹¹

4.3 Financial Capability Framework

According to World Bank, *“Financial capability is the internal capacity to act in one’s best financial interest, given socioeconomic and environmental conditions. It encompasses the knowledge (literacy), attitudes, skills, and behavior of consumers with respect to understanding, selecting and using financial services, and the ability to access financial services that meet their needs”*¹²

But why is Financial Capability so important? Financial Capability complements the objectives and agenda of Financial Inclusion. In fact, the policies and the programmes that are directed towards achieving financial inclusion cannot be framed without knowing the level of financial capability of the target demographic groups. As Center for Financial Inclusion, World Bank and ACCION rightly point out that *“Successful financial inclusion requires financially capable consumers. Within this decade, an enormous number of first-time clients, a large number of them from traditionally unserved population segments, will begin using formal financial services. But this expansion of financial services at the base of the pyramid must be accompanied by attention to financial capability if is to bring the desired benefits for providers, governments, and most of all, for clients”*¹³

⁵ (Source: Financial Capability Surveys Around the World Why Financial Capability is important and how surveys can help, World Bank, August 21, 2013)

⁶ 2014 Morocco Financial Inclusion and Capability Survey retrieved from <http://www.worldbank.org/en/topic/financialinclusion/publication/2014-morocco-financial-inclusion-and-capability-survey>

⁷ Enhancing Financial Capability and Inclusion in the Philippines - A Demand-side Assessment – July 2015, World Bank Group Finance and Markets

⁸ Kenya’s Financial Transformation in the 21st Century, FSD Kenya, 2015 edited by Amrik Heyer and Michael King

⁹ Understanding Financial Capability in Canada Analysis of the Canadian Financial Capability Survey, retrieved from http://publications.gc.ca/collections/collection_2011/fin/F2-213-2011-eng.pdf

¹⁰ Commission for Financial Capability, retrieved from <https://www.cffc.org.nz/>

¹¹ The Pioneer, 2018

Therefore, a good understanding of financial capability and its measurement will fulfill the following objectives:

1. Identifying the actionable weak areas of capability.
2. Identify potential and appropriate channels for delivering information and financial education.
3. Understand the relationship between financial knowledge/literacy and behavior. The relationship can be studied through the following framework in the form of a matrix.
4. Understand individual behavior with respect to personal or household finances.

The above objectives are further explained through illustrative examples.

4.3.1 Identifying the actionable weak areas of capability

(For example if kisan credit card is not used actively by a farmer, a survey can assess whether the actual reason is inadequacy of knowledge, complexity of use or lack of trust, no need, etc.)

Actionable Weak Areas	Reasons	Dimensions
Non usage of Kisan Cards	Inadequacy of Knowledge	Literacy, knowledge
	Complexity of Use	Skill
	Lack of Trust	Attitude
Stagnation in SHGs	Channelization of Funds	Knowledge & Literacy
	Organizing into Business activities / Livelihood	Knowledge , Skill, Attitude
	Inter group Conflicts	Attitude & Behaviour
	Risk Avoidance	Attitude & Behaviour
No Deposits in Bank Accounts / Dormancy	Managing Multiple Accounts	Skill
	Lack of Savings & Planning	Skill
	Opened for one-time subsidy / benefit	Attitude & Behaviour
	No understanding of Benefits & Implications	Knowledge & Literacy

¹² Definition by World Bank, Retrieved from <http://responsiblefinance.worldbank.org/publications/financial-capability>

¹³ (Source: “Enabling Financial Capability Along the Road to Financial Inclusion” A Joint Publication of Center for Financial Education, World Bank & ACCION, September 2013)

4.3.2 Identify potential and appropriate channels for delivering information and financial education.

Delivery	Dimension	Channel
Information	Knowledge, Attitude, Skills	Mobile SMS, outreach Programme, Television Campaigns, Public Administration Offices, Community & NGOs, Banks etc
Education	Knowledge, Attitude, Skills	Mobile SMS, outreach Programme, Television Campaigns, Public Administration Offices, Community & NGOs, Banks etc

It is to be noted that the choice of channel should be coherent with the capability component that ought to be addressed that is Knowledge, Attitude or Skills and also whether the delivery aims at providing some information only or looking at prolonged education. The paper titled “From Access to Usage: Behavioural Economics Interventions for Better Financial Capability” by

Singh, 2019, proposes a model for delivery mechanisms and a combination of channels that can be used for delivering financial education messages to enhance capability.

4.3.4 Understand the relationship between financial knowledge/literacy and behavior.

The relationship can be studied through the following framework in the form of a matrix.

Knowledge and Literacy			Behaviour		
Awareness about Schemes	Yes	No	Availing Benefits	Yes	No
Penalties of late payments	Yes	No	Paying Bills / EMIs on time	Yes	No
Numeracy Skills	Yes	No	Financial Planning	Yes	No
Insurance (Life, General, Agri)	Yes	No	Availed Insurance	Yes	No
Availing Loans	Yes	No	Productive Usage of Credit	Yes	No
Use of Technology (ATMs, Debit Card, Credit Card)	Yes	No	Actively Using	Yes	No
Digital Finance (Mobile Banking, Internet Banking, e wallets)	Yes	No	Use of Mobile Wallets/ Digital money	Yes	No

¹⁴ Retrieved from <http://www.jetir.org/view.php?paper=JETIR1904O90>

4.3.5 Understand individual behavior with respect to personal or household finances

Personal Household Finance	Factors Impacting Behaviour
Day to Day Money Management	Socio Economic Set Up, Mindset & Attitude, Motivation, Peer Influence, Formal and Informal education
Long Term Financial Planning	Socio Economic Set Up, Mindset & Attitude, Motivation, Peer Influence, Formal and Informal education
Building Sustainable Livelihoods	Socio Economic Set Up, Mindset & Attitude, Motivation, Peer Influence, Formal and Informal education

4.3.6 Multidimensional Nature of Financial Capability

The concept of Financial Capability is multidimensional in nature (as illustrated in Fig.1) and therefore each dimension will require a series of investigations to get the overall picture of capability. In this regard, a broad conceptual framework has been given by the World Bank.

Figure 1

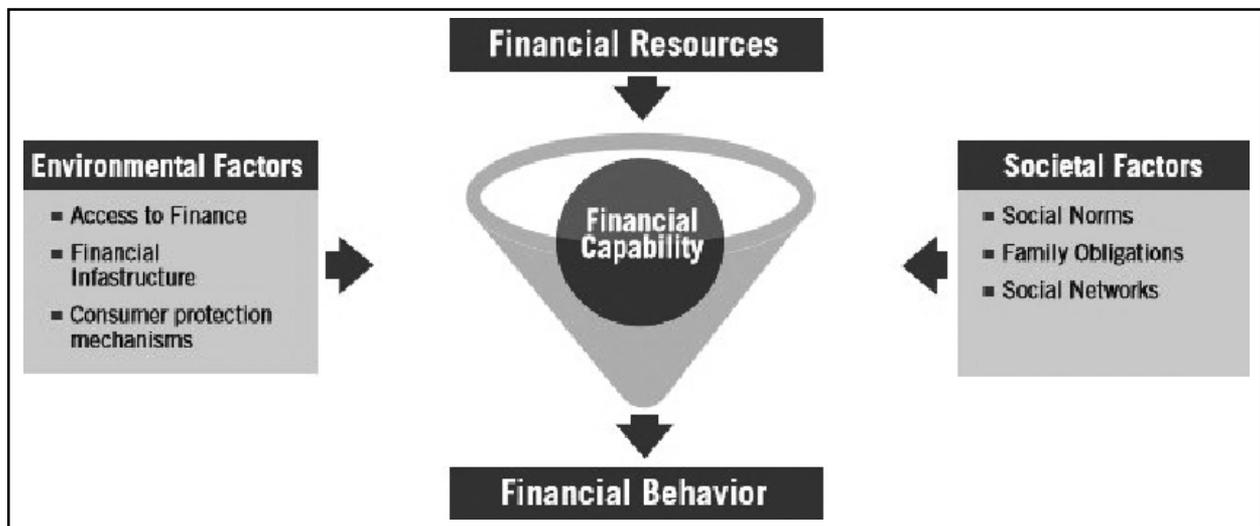
Financial Capability Concepts			
Knowledge	Skills	Attitudes	Behaviors
<ul style="list-style-type: none"> ■ Knowledge of financial concepts (inflation, compound interest etc.) ■ Awareness of financial products and services ■ Practical Know-how (how to make payments, how to open a bank account etc.) 	<ul style="list-style-type: none"> ■ Numeracy Skills ■ Literacy Skills 	<ul style="list-style-type: none"> ■ Reasons for or for not saving, borrowing, investing, etc. ■ Attitudes Towards the future ■ Confidence in own plans for old age ■ Proclivity towards budgeting, saving, lending etc. 	<ul style="list-style-type: none"> ■ Money management (managing day-to-day finances). ■ Long-term planning (preparing for emergencies and retirement) ■ Financial decision-making (ability to choose appropriate financial products) ■ Seeking financial advice.

(Source: *Financial Capability Surveys Around the World, Why Financial Capability is important and how surveys can help.* World Bank, August 2013.)

Moreover, given the nature of the problem, different dimensions may require different levels of attention from policy makers and service providers. So, it is quite possible that a targeted tailor- made solution or intervention may be required to modify behaviours rather than disseminating knowledge. For instance, evidence from the World Bank’s research initiatives supported by the Russia Financial Literacy and Education Trust Fund (WB/Russia Trust Fund) shows that knowledge of financial products is not very relevant in indicating financial capability in developing countries, which may be linked with lower levels of access to financial services (Kempson, et al, 2017).

Though Financial Capability is quite intrinsic to an individual, it is also impacted by external factors like Financial Access, Availability of Resources, Family and Societal Norms. So, an individual's capability should be assessed in the light of these external factors also. (See Fig. 2). The authors do not claim that financial capability can alone solve the intricate issues of poverty and lack of sustainable livelihood as the aspects of real sector are equally if not more, important for taking up an economic activity. However, attention towards building of financial capability will add more impetus to the ongoing supply side efforts of Financial Inclusion by enhancing the demand side aspects. (Pull Factor)

Figure 2



Source: World Bank 2013. “Financial Capability Surveys around the World. Why Financial Capability is important and how surveys can help.” World Bank. Washington, DC.

5. Measurement of Financial Literacy as a proxy to Financial Capability

In India, so far two studies have been conducted to measure Financial Literacy namely, “Financial Literacy and Inclusion in India” by NCFE and “National Financial Inclusion Survey (NAFIS)” by NABARD. The authors understand that both these studies are a proxy to measure Financial Capability. A critical review of these approaches has been presented in the subsequent sections.

5.1 National Centre for Financial Education

National Centre for financial Education, Mumbai (NCFE) which is a Section 8 (Not for Profit) Company promoted by Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI) and Pension Fund Regulatory and Development Authority (PFRDA) have published a report in 2014, entitled “Financial Literacy and Inclusion in India” which broadly measures the Financial literacy in terms of knowledge, attitude and behavior.

They employ ‘Financial Literacy Index’ methodology developed by Banerjee et al. (2016) and Banerjee et al. (2017). The survey results developed individual scores for ‘attitude index’, ‘knowledge index’ and ‘behavior index’ for all states and union territories. However the results were not used for building better financial capabilities through tailor made and need based policies and programmes. Also the researchers did not account for the “skill” dimension which is also an aspect of Financial Capability. The study covers rural as well as urban areas and deals with all sorts of banking products and services

ranging from simple remittances to capital market investments. The broad focus of the study across geographies and products makes it difficult to use in the context of financial inclusion policies and initiatives that are targeted largely at the poor. The authors hardly find a mention of the survey in related publications about initiatives of financial literacy and inclusion. To this effect, we fail to find much documented literature of such surveys in India. Nevertheless, the results give us deep insights into financial behaviours of individuals which could impact lot of policy planning and further focused researches in related areas in the form of action research should be encouraged.

5.2 National Financial Inclusion Survey (NAFIS) by NABARD

NABARD's National Financial Inclusion Survey (NAFIS) for the year 2016-2017, NAFIS adapted OECD/ INFE framework for measuring the level of financial literacy in the target households. Financial literacy in the context of this study is taken to connote a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well being. Unlike the NCFE survey, the study conducted by NABARD has dealt exclusively with rural and semi urban households. Therefore, it gives better results which could be helpful for further policy planning in respect of rural financial inclusion. The study though covers the major dimensions of knowledge, attitude and behaviour, it does not fully take into account the exhaustive list of sub factors that actually shape up the major dimensions. Here also the researchers did not account for the "skill" dimension which is also an aspect of Financial Capability. However this limitation could be attributed to the fact that the survey gives an overall macro picture of Financial Inclusion in Rural Areas and therefore has incorporated other important aspects like livelihoods, consumption, savings, investment, loans, insurance, pensions and retirement planning, microfinance, etc. The results of the study have opened up new areas of research in two categories "Understanding and Measurement of Capabilities" and "Developing Demand Side Interventions / Solutions to build the Desired Capabilities".

Both the reports have touched the dimension of financial capability and findings of the study give us some good insights into financial literacy / capability. But none of the studies have mentioned about the demand driven approach of capability explicitly or suggested ways, means and interventions to build capabilities for better financial inclusion.

But a careful analysis of both the studies tells that a paradigm shift from financial literacy to financial capability is already taking place, albeit, in an unstructured manner.

The supply side with the campaigns of GoI, RBI, NABARD, NCFE etc., has been very active and quite effective in reaching out to the target group. The authors would like to humbly state that understanding of the designers of these measures, seem to be limited as most of these measures are aimed at supply side rather than stimulating demand.

5.3 Evolution of Institutional Efforts for Financial Literacy

While Financial Inclusion has been on India's development agenda for a long time now, efforts towards financial literacy have taken off only in the recent years. Moreover, the push for financial literacy has come from RBI, apex level institutions like NABARD and a few NGOs / foundations who have been working for poverty alleviation and related areas of financial inclusion. India has carved out a National Strategy on Financial Education in 2012 comprising major components of literacy in terms of personal decision making and imparting basic financial education at school level through structured curriculums. In order to ensure effective coordination of the efforts made by all the financial regulators

and other stakeholders, a Technical Group on Financial Inclusion and Financial Literacy was constituted under the aegis of Financial Stability and Development Council, having representations from the Reserve Bank, SEBI, PFRDA, IRDA, Government of India, State Governments and Central Education Board etc. So ‘Financial Education’ remained a national goal for apex level institutions and not many main stream banking players took lead to work on such projects.

5.4 Timeline of Financial Literacy Initiatives in India

The following table summarizes the major milestones achieved towards financial literacy since 2007:

Year	Milestones	Outcome
2007	RBI constituted a working group under the Chairmanship of Shri. C.P. Swarnakar and Dr S.S. Johl	The working group emphasize the need for credit and technical counseling for the masses particularly in the underdeveloped regions
2009	RBI advised State Level Bankers’ Committee to set up FLCC Centers on pilot basis	Accordingly several lead banks set up FLCCs in their lead districts like “Abhay” by Bank of India, “Grameen Paramarsha Kendras” by Bank of Baroda and “Disha” by ICICI Bank
2012	A nationwide survey on FLCC was conducted by RBI, revealing many limitations of their functioning and upscaling.	Revamping existing FLCCs into FLCs with renewed focus on Financial Literacy ¹⁹
2014	Introduction of PMJDY scheme by Government of India	Financial Inclusion was launched in a mission mode through opening of large number of bank accounts for the masses.
2016	RBI issued revised guidelines for FLCs to focus on keeping the PMJDY accounts active through financial literacy efforts.	RBI issued revised guidelines for FLCs to focus on keeping the PMJDY accounts active through financial literacy efforts. Banks were advised to adopt a “tailored approach” for different target groups. RBI also spelt out various stakeholders that need to be involved in financial literacy campaigns including LDM of the Lead Bank, DDM of NABARD, LDO of RBI, District and Local administration, Block level officials, NGOs, SHGs , BCs , Farmers’ clubs, panchayats, PACS , village level functionaries etc. Further, RBI also elaborated on the detailed requirement of FLC architecture.

¹⁵ Retrieved from <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/NSFE016072012.pdf>

¹⁶ Retrieved from <https://www.rbi.org.in/scripts/PublicationDraftReports.aspx?ID=526>

¹⁷ Retrieved from <https://www.rbi.org.in/scripts/notificationUser.aspx?Id=4822&Mode=0>

¹⁸ Diwakar Hegde (et al. 2017)Sustainability of Financial literacy Centers – A Comparative Analysis, Article in RBI’s publication “CAB Calling “

¹⁹ Retrieved from <https://m.rbi.org.in/scripts/AnnualReportPublications.aspx?Id=1041>

²⁰ Retrieved from <https://www.pmjdy.gov.in/scheme>

Year	Milestones	Outcome
2017	RBI initiated a block level “Centers of Financial Literacy (CFL)” pilot project across 80 blocks in 9 states in the year 2017	To develop innovative and participative approaches to financial literacy by empowering ‘change agents’ by training them.
2018	2018 RBI has prepared a draft of “National Strategy for Financial Inclusion”	Government to assign pre-set goalposts for RBI and the other financial and economic regulators,

Some of the important initiatives discussed above are elaborated in the following paragraphs:

5.4.1 Financial Literacy and Credit Counseling Centers

To further the goals of financial literacy, banks were advised to set up Financial Literacy and Credit Counseling Centers as a trust or society. It was recommended that these centers would be initially promoted and sponsored by banks by owned or pooled resources. However, they would function as independent set ups and devise training activities and programs as per the category of borrowers.

Further guidelines were issued in terms of objectives, organizational and administrative set up, coverage, charges, types and mechanisms of credit counseling, qualification of trainers, transparency and disclosures, etc. The FLCCs were to impart financial literacy in the form of simple messages like:

- Why save?
- Why save early in your Life?
- Why save with banks?
- Why borrow from Banks,
- Why borrow as far as possible for income generating activities?
- Why repay in time?
- Why insure yourself?
- Why save for your retirement?

The above truly entails the essence of educating people especially the rural households to borrow responsibly and lead to attitudinal change in terms of savings and borrowing habits as well as its productive usage. It may not be wrong to say that this was the first initiative in the direction to address demand side barriers of Financial Inclusion.

²¹ Retrieved from https://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=10222

²² LDM= Lead District Manager

²³ DDM= District Development Manager

²⁴ LDO= Lead District Officer

²⁵ Self Help Groups

²⁶ Banking Correspondents

²⁷ Primary Agriculture Cooperative Society

²⁸ Financial Literacy Centre

²⁹ Financial Inclusion Policy & Progress, RBI 2016

³⁰ RBI prepares for full financial inclusion in hinterland, Economic Times 2019

It may be however observed from the above description that the role envisaged for FLCCs mainly addressed the “Whys” and not the “Hows”. Hence there is a greater need for focus on building capabilities on “Hows”.

However, a nationwide sample survey of 30 FLCCs spread across 16 States in 2012, by RBI revealed many limitations in the functioning of these FLCCs. Most of the FLCCs were functioning as a mere extension of banks and were manned by agricultural officers of the banks. The centers were heavily dependent on the banks for funds and as such functioning as a separate entity was a big challenge. Moreover, the concentration of the centers remained in urban areas and a chunk of the rural, financially excluded population remained outside its ambit. A massive scale up of this existing scheme was required and it was envisaged that the ongoing scheme should be overhauled so that concentrated efforts towards financial literacy could be made.

5.4.2 Financial Literacy Centers

To achieve the renewed focus on financial literacy, Lead banks were advised to set up Financial Literacy Centers (FLCs) in each of the Lead District Manager (LDM) Offices in a time bound manner. This will lead to opening of 630 plus FLCs in all the districts throughout the country.

This was in addition to the already established FLCCs. Since then FLCs and rural branches have received continuous support and framework guidelines from RBI and financial assistance from Financial Inclusion Fund, constituted at NABARD to carry out financial literacy activities and programmes.

If one looks at the existing ecosystem of financial literacy, it instills a sense of optimism that literacy will eventually lead to capability. The efforts made by RBI/NABARD in this direction are truly commendable and there is no debate around the fact that financial literacy forms a core of the demand side of financial inclusion.

5.4.3 Centers of Financial Literacy

Interestingly, a new dimension to Financial Literacy has emerged in this existing landscape as RBI initiated block level Centers of Financial Literacy (CFL) pilot project across 80 blocks in 9 states in the year 2017. The project is a collaboration of 6 NGOs and 10 sponsor banks. The thrust of this project is to understand innovative and participative approaches to financial literacy by empowering the ‘change agents’. These ‘change agents’ are further nurtured through training and they reach out to their respective communities. NGOs work with low income communities to build their financial capabilities. The trainers and community financial health workers engage with the community and deliver financial education. Anganwadi teachers, ASHA workers and self-help group leaders who demonstrate good communication skills are recruited from amongst the community as ‘change agents’. Peer learning and participatory learning methods are among the key components of the pedagogy.

According to the authors, this is where the seeds of financial capability have been actually sowed because these change agents not only impart knowledge but also work on attitudinal and behavioral transformation which goes a long way in building capabilities for better decision making in the true sense. Peer learning is a powerful tool and using it as a demand side intervention can make wonders for

³¹ (Source: RBI Annual Report on Credit Delivery & Financial Inclusion August 2017)

financial inclusion. While the impact assessment of the pilot project is underway, we are hopeful that the good practices towards financial literacy will emerge and we will be in a better position to understand the capability approach.

So far financial literacy looked like another push phenomenon just like other ongoing financial inclusion schemes. So much so that RBI has taken massive efforts in creating and designing financial literacy material and modules, quizzes and competitions and other innovative approaches like financial literacy week and drives. Similar efforts have been made by NABARD, SEBI and IRDA in their respective domains.

However, we are yet to see integrated efforts from the banks's side as far as demand side interventions are concerned. Thus, all efforts of literacy will boil down to a supply side issue without taking too much heed of the demand side requirements. They continue to execute the schemes and programmes designed by RBI, thereby making people more aware rather than capable.

6. Why do we need to graduate from Financial Literacy to 'Financial Capability'?

A good understanding of the Financial Capability Framework will tell us that literacy or knowledge is the starting point towards a better Financial Capability. So far financial literacy has been considered synonymous to financial capability. However, capability is a much broader concept which entails other aspects like attitude and mindset, motivation, behavior, social norms and peer influence etc. Knowledge or awareness is the beginning point towards building any type of capability of an individual. It leads to attitudinal change by addressing demand side barriers of financial inclusion and hence builds the skills required for making a financial decision.

Research shows that formal financial education or literacy imparted through classroom approach does not have the desired impact for financial inclusion. Fernandes, 2014, questions that formal financial education system is of little good when it comes to financial decision making. His study reveals that *“that content knowledge may be better conveyed via “just-in-time” financial education tied to a particular decision, enhancing perceived relevance and minimizing forgetting”*. This research is a rich bibliographical account of what has been said so far in the area of financial literacy and education of financial literacy, though an important ingredient of the Financial Inclusion should be timely, relevant and contextual. This is possible only when the designers of policies and programmes understand the current capabilities and hence design a literacy program which is tailor made for a specific group of individuals. To illustrate this let's take a very simple example. Suppose an awareness camp regarding “Crop Insurance” is organized by a bank or any financial institution for farmers in a village. Prima facie it seems that this initiative will lead to more awareness about benefits of insurance to protect crop losses. However how does this camp deal with the behaviour of avoiding insurance as a service, that farmers have developed over a period of time? Does this camp take into account what other insurance services the individuals have availed to understand how skilled they are in understanding concepts like premium payments and its implications? If not, then this camp remains financial literacy initiative of the bank and not a capability building approach which actually leads to the desirable change in the behavior of the farmer i.e., buying crop insurance.

In such a case, it is essential that such programmes should have an inbuilt component of behavioural interventions which can lead to a better financial decision making by individuals.

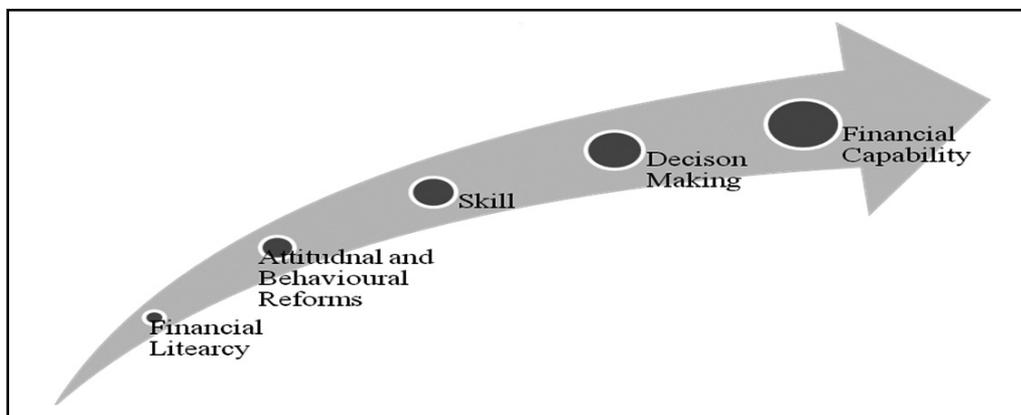


Figure 3: Shifting Trajectory from Financial Literacy to Financial Capability

7. Suggestions and way forward to graduate from Financial Literacy to Financial Capability

It may be observed from the above discussions and analysis, that although over a decade has passed after the initial steps by RBI in the field of Financial Literacy since 2007, we are still far away from a firm and structured approach towards complete financial literacy and inclusion. We are yet to graduate to the level of financial capability as it has not yet been adopted in the policy narrative. The authors strongly feel that we need to shift to the new paradigm of financial capability to achieve sustainable livelihood and financial prosperity for one and all especially for the poor and financially excluded.

Therefore following suggestions are made for consideration of the key policy makers and other stakeholders:

- i. Financial Literacy alone will not enable a poor/excluded person to exploit the potential benefits of financial inclusion. So we need to include the dimensions of financial capability in campaigns, literature and other initiatives of Financial Literacy.
- ii. There is a need to develop new approaches towards financial education for different types of financial decision making. This ranges from everyday money management decisions to long term financial planning to sustainable livelihoods. A good example could be ‘Just in Time’ education.
- iii. Traditional methods of imparting literacy can be replaced with innovative approaches driven by cutting edge technologies. In India, more than 50 percent of the unbanked adults have a mobile phone. India is entering a Fintech Revolution where technological innovations can play a major role in achieving financial inclusion in rural areas (*Grameen Foundation India , 2016*)
- iv. The World Bank’s Findex Report (World Bank, 2017), shows that the gender gaps in account ownership have still not reduced and 60 % of the unbanked adults in India continue to be women. So, it is important to delve deeper into the specific issues and challenges faced by women in using financial services and need based interventions are required to tackle gender related issues of financial inclusion.
- v. Innovative approaches of credit counseling for especially vulnerable sections of the society like small and marginal farmers are need of the hour because many farmers are still in the clutches of money lenders and other informal sources for their financial needs. (*Times of India, 2019*)

- vi. To escape the poverty trap, it is not only the availability of credit but also the ability to use it is important. This comes when a person is made more capable of generating income through a self-sustaining livelihood activity. This should be envisaged in the existing initiatives of financial literacy e.g., there should be more emphasis on livelihood generation in the financial literacy programmes.
- vii. Financial Inclusion can make a deep social impact and is a key enabler of at least nine SDGs. Many social problems can be solved through behavioral economics interventions (like Nudge Theory) rather than regulations. The ultimate aim is good financial decisions and not mere increase in awareness levels.
- viii. The capability approach towards financial inclusion will encompass several aspects of financial decision making in terms of knowledge, attitude and skills. Some of the key aspects of financial decision making may be overlooked by the policymakers if we fail to understand the aspects of Financial Capability.
- ix. Financial services and products are composed of remittances, savings, credit, pensions, investments, insurance etc. Demand, usage and knowledge differ across categories. Thus, capability approach will enable us to understand what solutions will work in which areas.
- x. The National Strategy on Financial Education of 2012 needs to be appropriately reconstituted by incorporating tailor made education for different types of target groups. Presently the existing efforts of financial literacy are not reflected well in the strategy as most of the initiatives are directed towards revising school curriculums.
- xi. India is in the process of designing a Financial Inclusion Strategy. At this juncture, it shall be meaningful if financial capability aspects like levels of literacy, technology adoption, peer to peer learning, usage of credit etc., are considered and given due importance while designing this strategy so as to enable us addressing demand side issues.
- xii. Although some work on financial literacy measurement has been done by NAFIS and NCFE, it is yet to be capitalized by incorporating these insights into practice. Further strengthening of such efforts is required by giving due credit and recognition to the capability concept.
- xiii. More research is required in the areas of Behavioural Economics in Indian context to understand the intricacies of Financial Capability. This will enable us to have a focused approach towards designing policies and programmes for better Financial Inclusion.

8. Conclusion

Financial Capability and Financial Literacy are complementary to each other. Hence the authors would like to submit that financial literacy is necessary but not sufficient condition for achieving the objectives of Financial Inclusion.

The full potential of financial inclusion will not be achieved till the time demand side barriers are addressed in a holistic manner. Therefore, the existing efforts of financial literacy should be understood in the context of “existing capabilities” and “desired capabilities” to use products and services. A beginning has already been made but sensitizing the various stakeholders on capability is important. Such efforts should be a part of the national mission on financial inclusion where we empower and enable people through innovative approaches. We have reached out to them with a bouquet of financial offerings and now it’s the time for some attitudinal transformation and behavioral interventions.

The authors firmly believe that a better understanding of Financial Capability will unlock the potential of development.

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