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Financial Literacy among Working Young in Urban India

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Summary. — The working young in urban India exhibit inferior financial knowledge, inferior financial attitude, and superior financial behavior compared to their counterparts elsewhere. While both men and women require intervention to enhance their financial knowledge, focused intervention is needed to improve the financial attitude of men and the financial behavior of women. Living in a joint family impacts financial literacy negatively and consultative decision-making in families impacts it positively. The influence of these key aspects of Indian family life indicates the need to involve family members in financial literacy programs to improve financial decision making of families.

Key words — financial literacy, financial knowledge, financial behavior, financial attitude, youth, India

1. INTRODUCTION

The role played by governments and employers across the world in securing the financial future of individuals has shrunk significantly in the recent past, particularly in emerging economies. This change in social support structures is accompanied with increasing life expectancy, rising costs of healthcare, and increasing sophistication of financial products. As a result, it has become imperative for individuals to develop a more nuanced understanding of the world of finance to secure their financial future. However, research from around the world on financial literacy raises serious concerns about the ability of individuals to secure their financial well-being. There is evidence that individuals under-save, fail to invest wisely, and are often indebted (Mitchell, 2011; Reed & Cochrane, 2012). Increase in financial literacy is found to improve financial decision making. In a recent study, Biener, Eling, and Schmit (2014) show strengthening of the microinsurance market through enhancement of financial literacy. Governments around the world have started to recognize that financial literacy is a critical life skill and have launched financial education initiatives to help young people acquire this skill (see e.g., ASIC, 2013; RBI, 2012).

Lusardi, Michaud, and Mitchell (2013) demonstrate that financial literacy training at an early stage in the working career has a greater impact on financial outcomes as returns are compounded over a longer period. This paper reports the results from perhaps the first study that rigorously investigates the influence of socio-demographic attributes on financial literacy of the working young in urban India. The study is highly relevant to India as it is a rapidly urbanizing nation, with more than 65%[1] of its population below the age of 35. Moreover, India being the second most populous and the third largest country in terms of GDP in PPP terms in the world, the study is of relevance in the larger global context. The findings provide guidelines for policy making to improve financial literacy of the working young. As Biener *et al.* (2014) argue, perhaps lessons learned from emerging economies offer opportunities for 'reverse innovations' that can assist in extending economic advantages to low-income populations in advanced economies.

The paper is organized in eight sections. Section 2 provides a brief review of relevant literature; Section 3 details the sample; Section 4 discusses the measurement of literacy and data collection approach; Section 5 provides a comparison between India and other countries; Section 6 details the methodology used for analysis; Section 7 discusses the results from the regression model and Section 8 concludes.

2. LITERATURE REVIEW

A number of field studies around the world find that a significant fraction of individuals has a low level of financial knowledge (for instance, Lusardi & Mitchell, 2008; Lusardi & Tufano, 2009; Van Rooij, Lusardi, & Alessie, 2011). Low financial knowledge is associated with sub-optimal financial outcomes in many areas such as retirement planning (Lusardi & Mitchell, 2007), borrowing decisions (Lusardi & Tufano, 2009), and stock market participation (Van Rooij *et al.*, 2011). There is also evidence that financial literacy is a multi-dimensional construct and separately measuring its different dimensions is important. Schicks (2014) finds that while over-indebtedness is lower for borrowers with good debt-literacy, general financial literacy and numeracy seem insufficient to reduce over-indebtedness.

A recent stream of theoretical literature attempts to explain the observed low levels of financial literacy and suggests possible policy interventions. This literature beginning with Delavande, Rohwedder, and Willis (2008) treats acquisition of financial knowledge as an investment in human capital. Absent policy intervention, a low level of financial literacy may be individually rational for certain groups of people as the cost of acquiring financial knowledge (time, effort, and money) exceeds the benefits (higher returns on their saving). Jappelli and Padula (2013) use an inter-temporal model to

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identify the optimal investment in financial literacy. They find that the stock of financial knowledge is influenced by individual preferences, household resources, and the cost of acquiring financial knowledge. Lusardi *et al.* (2013) develop richer models of the interaction between financial knowledge and investments in the presence of other important dynamics such as borrowing constraints, mortality risk, and demographic factors. Incentives play a significant role in the acquisition of financial literacy.

Gender has a significant influence on financial literacy. Fletschner and Mesbah (2011) find that women are less financially informed than men; however, their knowledge improves significantly with education, wealth, and encouragement by spouses to acquire and use it. Hsu (2011) finds that women invest in financial literacy as the spouses start to lose cognitive skills. Swamy (2014) finds that families where women also participate in financial decisions have greater percentage rise in family income.

Field surveys in several countries have documented low levels of financial literacy among important socio-economic groups including the young. Lusardi, Mitchell, and Curto (2010) investigate financial literacy among young adults in the US based on the National Longitudinal Survey of Youth and found low levels of financial literacy. They find a significant difference between women and men, with women showing lower financial literacy. Their finding is in line with the low financial literacy levels reported among older adults (Lusardi, Mitchell, & Curto, 2014), older women (Lusardi & Mitchell, 2008), and high school students (Mandell, 2008) in the US. Low financial literacy is also reported for various population sub-groups from other developed and less developed countries. Most studies on financial literacy in India conclude that the level of financial literacy is poor. For instance, the VISA (2012) study ranks India at the 23rd position among the 28 surveyed countries. Despite the differences in target population sub-groups, most of the empirical studies find significant positive influence of education and income on financial literacy.

Two extensive recent reviews of the research on financial literacy are Lusardi and Mitchell (2014) and Fernandes, Lynch, and Netemeyer (2014). Lusardi and Mitchell (2014) who review the theory and field studies, conclude that the interventions to improve financial literacy are only partially successful. Fernandes *et al.* (2014) conducted a meta-study of the financial research and report significant association between measured financial literacy and financial behavior.

Theoretical models suggest that certain socio-economic groups based on income, education, and gender may have low levels of financial literacy. Government intervention to improve financial literacy will be needed when the low literacy is due to limited or costly access to literacy programs. Intervention may also be warranted on grounds of equity and equality of opportunity as large variations in financial literacy can lead to large inequalities of wealth (Lusardi *et al.*, 2013). Interventions by government may also be necessary when a country embarks on significant financial liberalization and shifts to a system with greater individual choice in retirement savings.

3. SAMPLE

The study is focused on the working young in urban India earning less than INR 30,000 per month (approximately USD 500). Given the wide socio-economic diversity, the sample is drawn from six major cities spread across India through a survey in May, 2012 by engaging the services of an established market research agency. The six cities include the four most populous cities of India (Mumbai, Delhi, Bangalore, and Hyderabad) and two other metropolises of India (Chennai and Pune). Delhi is the national capital, and Mumbai is the financial capital of India. Bangalore, Hyderabad, Chennai, and Pune have grown to become the major hubs for information technology-enabled services in India and attract a large number of youngsters from other parts of the country. These cities are major economic centers of India and have experienced rapid urbanization over the last decade. The cities are among the top seven cities of India in terms of size of aggregate deposits/gross bank credit as of March, 2012. As a significant proportion of the young in these cities hails from different parts of India, the sample captures the diverse character of the country.

The attributes of the respondents on which data are collected are gender, age, education level, marital status, family income, financial decision-making process, and budgeting of expenditure. A distinctive feature of Indian society is that even after marriage a male may live with his spouse and children under the same roof with his parents, brothers, and their families – in what is known as a 'joint family'.[2] As joint-family set up may have a significant influence on the financial decision making, data are also collected on whether the respondents live in a nuclear or a joint family. Living in a nuclear or a joint family should not be confused with being married or unmarried.

Though the target sample size was 1,000, after preliminary analysis of the data, the usable sample, with information on all dimensions and variables, is reduced to 754. All the respondents are second-generation urban youth. All of them operate a savings bank account and therefore are financially included. The distribution of the sample across different levels of the attributes and the associated scores for the response variables are presented in Table 1. About 23.3% of the respondents in the sample are women which is marginally higher than the proportion of women in the working population in the above cities (about 20.5% as per authors' estimate based on 2009–10 NSS data[3]). The gender-wise distribution of the sample across different values of various variables is similar. About 93% of the respondents are aged 30 years or below. It is, therefore, not surprising that 73% of the respondents are unmarried. About 72% of the respondents are graduates, and 19% are post-graduates. The proportion of respondents with college education is high as the respondents are employed in the service sector.

4. MEASUREMENT OF FINANCIAL LITERACY

While several widely used definitions of financial literacy exist, all of them generally imply the ability of individuals to obtain, understand, and evaluate information required to make decisions to secure their financial future as best as possible. Huston (2010) proposes that financial literacy must also include application of financial knowledge; the argument being that absent demonstrated ability to apply financial knowledge, an individual cannot be regarded as financially literate.

After considering the different views and the feasibility of using the definition for field research, the OECD INFE (Organization for Economic Cooperation and Development, International Network on Financial Education) definition of financial literacy, "A combination of awareness, knowledge, skill, attitude and behavior necessary to make sound financial decisions and ultimately achieve individual financial