Shyamala Gopinath: Inclusive growth – role of financial education

Special address by Ms Shyamala Gopinath, Deputy Governor of the Reserve Bank of India, at BANCON 2006, Hyderabad, 4 November 2006.

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I am aware you have had illustrious speakers and expert sessions on various issues reverberating in policy conundrums of 'financial inclusion' and financially inclusive growth. Why I term these as conundrums is for the reason that on the one hand, everyone accepts that a broad based access to formal financial services is a *sine qua non* for the aspiration of growth in GDP and economic development at large to be fulfilled; while on the other, the initiatives emerging in this direction have at best been confined to small pockets. The problem is not specific to India and many countries have been groping for the inflexion point in finding solutions to this problem. At the macro level, it is perhaps only in the recent past that this area is witnessing the academic rigour of the scale seen in the mainstream finance. It could be due to inherent nature of the issues we are grappling with. Most of the initiatives have been 'within the framework' solutions, which have inherent limitations. This point comes out all the more starkly in the context of the explosion in financial innovations and products witnessed in mainstream finance.

To elaborate this point, it would be interesting to look at the evolution of the discipline of finance in general and banking in particular. Till a few decades back, the field of finance itself was, in a sense, second cousin to the domain of 'economics' and it was only the revolutionary ideas and theories relating to asset pricing, particularly traded stocks to begin with, that changed the landscape. The subsequent academic contributions in the area of option pricing triggered the revolution in derivatives which has, in effect, commoditised the financing needs as well as options available to a certain segment of the corporate and retail sector. The above advances in the field of finance have evolved in response to a given set of circumstances in the industrial economies and the applications designed around these were aimed at a particular target group. Most of the principles have gradually found wide acceptance and have been imbibed across the globe, including India. We now need a similar revolution in fostering financially inclusive growth.

However, the needs of a complex country like India are very different and finding universal solutions to these could be really challenging, particularly in fostering a 'financially inclusive growth'.

Financially inclusive growth straddles a lot of issues which have been deliberated upon at length during the previous sessions. I intend to confine my address to one of the important facets of this challenge - the challenge of financial education.

Financial education - the concept

Financial education can be comprehensively defined as "the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being". Financial education thus goes beyond the provision of financial information and advice. The focus of any discussion on financial education is primarily on the individual, who usually has limited resources and skills to appreciate the complexities of financial dealings with financial intermediaries on matters relating to personal finance on a day to day basis.

Role of financial education vis-a-vis financial inclusion

In the context of 'financial inclusion', the scope of financial education is relatively broader and it acquires greater significance since it could be an important factor in the very access of such excluded groups to finance. Further, the process of educating may invariably involve addressing deep entrenched behavioural and psychological factors that could be major barriers. However, the complementary relationship between microfinance and financial education is obvious and financial literacy can increase the decision making power and prepare them to cope with the financial demands of daily life.

In countries with diverse social and economic profile like India, financial education is particularly relevant for people who are resource poor and who operate at the margin and are vulnerable to persistent downward financial pressures. With no established banking relationship, the un-banked poor are pushed towards expensive alternatives. The challenges of household cash management under difficult circumstances with few resources to fall back on could be accentuated by the lack of skills or knowledge to make well informed financial decisions. Financial education can help them prepare ahead of time for life cycle needs and deal with unexpected emergencies without assuming unnecessary debt.

As per an OECD study, the provision of education programmes for the un/underbanked groups can play important roles:

- they can encourage un/underbanked consumers to enter into or make better use of the financial mainstream,
- they can help to retain them as successful account holders in the short term and
- they can contribute to keeping them as savers for the long-term.
- they can contribute to asset building among households

Challenges in devising a financial education program

Devising financial education initiatives for the un/underbanked has to take into account the existing financial landscape, the social economic realities of this class and the fact that invariably, such groups are beset with low literacy levels.

The main difference in the financial planning for the poor families is that they have fewer resources and opportunities. When people are struggling to make ends meet on a day-to-day basis, good money management becomes a daily challenge. While they use many creative ingenuous strategies to manage their money, these often develop through trial and error rather than by design. Financial education has a role in 'building the capacity of the poor to gain control, become proactive, use information and resources to enhance their economic security and more effectively use financial services'. When better-informed clients become better consumers of financial services, financial institutions benefit.

Further, as already mentioned, the process of educating may invariably involve addressing deep entrenched behavioural and psychological factors that could be major barriers. For example, in case of many of the microfinance initiatives operating on the 'group liability' concept it could be a great challenge to drive home the very basic rationale for such an arrangement, starting from inculcating the habit of small savings to appreciation of the concept of 'collective responsibility'.

A study regarding Mexican experience has highlighted that the social and cultural factors embedded in the financial landscape greatly influence the ability of individuals to use financial services effectively. Results indicate that in addition to material resources, the inherent nature of social relations and community links played a crucial role in improving access to and use of financial services. The transformation of financial information, knowledge, experience, attitudes and social relationships into financial education and sophistication constituted a cognitive resource to reducing vulnerability. This leads us to suggest that a culture of finance is an important catalyst for individuals’ change and development.

It is also important to note that financial education may contribute to behavior modification, but many factors lend to influence a person’s financial behavior. Contrary to common belief, motivation is cultivated internally and rarely can be cultivated - sustainably, at least - by an external factor. The biggest obstacle to financial education is motivating individuals to pursue it. In other words, financial education does not necessarily motivate individuals; motivation brings individuals to financial education. Here the role of banks assumes importance as financial counselors of the clients.

Possible themes

Inspite of the above challenges, it should be possible to arrive at a set of basic themes/issues that could be addressed effectively through a financial education program. As per a study conducted by the under the project 'Financial Education for the Poor' by Microfinance Opportunities, a microenterprise resource center, a consistent demand was found for the following broad themes of financial education:

- Money Management: How to proactively manage money
- Debt Management: How to control debt and avoid over-indebtedness
- Managing Savings: How to save regularly and in a safe location
- Financial Negotiations: How to strengthen clients' bargaining position vis-à-vis input suppliers, other household members, and financial institutions
- Use of Bank Services: How banks work and impose charges; How clients can maximize bank services, interact with banks, and effectively use ATMs

An analysis of such programs in the OECD countries reveals that many educational programmes are integrated into the provision of specific financial services, such as first or basic bank accounts, checking and savings accounts and matched-savings plans while others adopt a broad stand-alone approach, teaching budgeting, savings and credit management, etc., with no connection to any product of service. Aims tend to vary according to the majority target population.

- For the generic unbanked, aims are to explain the benefits and use of bank account ownership and services or to build up fundamental financial literacy skills.
- For low/moderate-income underserved consumers, most programmes offer advice on general money and credit management; whereas others have a specific goal or are embedded in schemes to encourage savings, asset-building and homeownership.

These initiatives aim to build economic empowerment and increase long-term self-sufficiency in order to revitalize and stabilize disadvantaged communities.

Indian context

Financial education has an ever more critical role to play in the changed financial landscape of the country which, while on one hand has presented with newer opportunities for future collective growth, on the other, it has also heightened fears of uncertainty in certain quarters mainly because of increasing multi-faceted choices and options in the management of personal finances and exposure to a gamut of risks. The issue of inclusive growth has been given top priority and in this direction, the banking sector is expected to play its part. The initiatives on financial inclusion so far, have been a small step in this direction. Financial education could ideally supplement these initiatives for long term efficacy.

…Some issues

One of the major hindrances in the way of delivery of financial services is the lack of basic knowledge and lack of awareness of the products and services available from the banks. It is important to note that the Financial Inclusion Task Force of the United Kingdom, one of the pioneers to talk of financial inclusion, has identified 'access to free face-to-face money advice' as an important component of financial inclusion, apart from 'access to banking' and 'access to affordable credit'. People need information and advice when they either save their money or get into debt. Such information and guidance can best be delivered by appropriate mechanisms and if such effective mechanisms are put in place through the banks, they in turn would reinforce the demand for financial services.

Another impediment is the difficulty or the lack of ease of addressing issues that affect a common man. Despite concerted efforts, the current state of transparency coupled with the difficulty of consumers in identifying and understanding fine print information leads to an information asymmetry between the financial intermediary and the customer. It is important to understand that the lack of such awareness in itself amounts to risk; and the challenge is to make customers aware of the various risk.

In terms of promoting financial inclusion, much of the work is simply in providing easily understood information in a safe and engaging environment.

…Scope for financial education

Undoubtedly, there is a role for promoting financial education in the context of development policies and programs to reduce vulnerability and expand opportunities for the poor. To this end, there is a need to explore the potential for integrating financial literacy into various types of development programs: microfinance, vocational education, skills training, business development, health, nutrition, agriculture, and food security programs. In the late 1990s a move in the UK and US to have all Government payments made electronically contributed to heightening the importance of financial exclusion as a policy concern. Electronic government payments have made having a bank account essential in order to receive payments and benefits. This has made it all the more important for unbanked consumers to access information on basic bank accounts savings accounts and other financial services. Financial education programs would be required to access information on financial services.

In India too, improved technology will enable, for example, Governments to make all payments, including under various schemes electronically. I understand that in Andhra Pradesh, the State Government has taken initiative to make payments thorough e-seva. Other states have also launched such initiatives. Governments should now explore the possibility of direct credit to bank accounts. Eventually, part of the funds received by the beneficiary under various government schemes and deposited with the banks can form part of the seed capital for forming Self Help Groups (SHGs) for such beneficiaries.

While some banks have on their own taken steps to provide such education, any large scale delivery of financial education needs to leverage on the experience and expertise of other agencies, such as private entities, non-governmental organizations, civil society organizations, outlets of the corporate sector etc., apart from Government initiatives, wherever available.

The use of information technology offers a lot of promise in providing financial literacy and education and experience in several parts of the country through the use of rural information kiosks, mobile vans, etc. which have shown to what extent IT can be leveraged to provide information on various products and services. Information kiosks can be run by the Business Correspondents or installed in PCOs, etc. to disseminate information about not only banking products, but also other useful information like input/output prices, insurance products, health services, weather information, etc. Such variety of knowledge would help in better risk mitigation, lesser documentation hassles while sanctioning loans, etc. The kiosks need not even have any connectivity and the service personnel can perform most of the updating through electronic media like CDs. Banks can provide funds for setting-up such kiosks and meeting the running costs or the cost can be shared among banks, and the other organizations involved in the process.

Some non-banking initiatives are also being experimented in various parts of the country. In this context, the project on financial counseling service for poor self-employed women in India started by SEWA is well known. Project Tomorrow, as it is called, was started in 2001 with a purpose to develop and test a financial counseling curriculum to help participants manage money productively, plan ways to increase assets, address life cycle events, manage risks. Through this project, SEWA has set up a training unit and training delivery system and is developing tools and procedures to monitor the counseling work. The project began with market research to assess the needs and demand among SEWA clients for financial education, followed by a 'training of trainers' course. SEWA is now providing financial counseling to its clients through a weekly course. The initial experience suggests that participants grasp the concepts presented and welcome new perspectives stemming from such training.

…Extending the scope

- While talking about financial education, it is important that the focus also extends to the urban populace, including the literate masses, which may not be having the financial acumen, technology suaveness and may not be '*financially literate*'. It is not that the urban masses are well versed in the Internet Banking and other newer methods of banking; there continues to remain a segment, which either avoids using the services due to lack of confidence or remains unaware of the options available. Financial education to such target group would be mutually beneficial.

- There is also need for greater awareness of various products and services offered by banks. A specific case that comes to mind pertains to the housing finance sector. RBI had also raised the issue of transparency and fairness in housing loans in the recent mid-term review of monetary policy. It has been reported that some banks, while lending for housing, are not fully transparent in indicating the factors governing the benchmark in respect of floating rates as well as in regard to reset clauses. As part of consumer awareness, many initiatives have been taken to increase the disclosure levels on part of lenders, but effectiveness of all this would be predicated on the financial understanding of the person taking the loan. The short point is - Does the consumer understand the underlying principle of a floating rate or can he even ensure that the bank has been fair and transparent in its dealing with him? Clearly, there is need for financial education to prevent vulnerable consumers from falling prey to 'financially disquieting credit arrangements'.

Even in regard to remittance facilities and foreign exchange encashment, the lack of awareness about the various facilities could adversely impact a population segment at the 'bottom of the pyramid' which is the beneficiary of smaller remittances from migrant workers. Recently, a Working Group on Cost of NRI Remittances has stressed in its report the need for an ongoing 'awareness program' for imparting basic awareness on facilities existing for making remittances, particularly for migrant workers. Apart from other things, this could also help in reducing the cost of effecting remittances.

- Though the term 'financial education has come to be associated with individual/personal finance, a very important segment that must be brought under the ambit of such initiatives relates to small entrepreneurs and small businesses. Particularly when the effort is towards 'inclusive growth', it is these segments in smaller cities and towns that could really showcase the benefits of economic growth. The focus in such cases, would obviously be different, with greater stress on awareness and timeliness of financial advice, instead of just education. Such timely advice could be the deciding factor in the success or failure of their ventures. In all probability, the promoters of these small ventures would be educated and already have a business sense and a business idea that needs to be actualized. It is here that awareness about new financial products and an understanding of their pricing could enable them to ensure that they understand the downsides of the product, present and future, and be in a better bargaining position vis-à-vis the lender.
- Finally, the concept of financial education could ideally be stretched to cover economic education as well. At a broader societal level, given the path of economic reforms India has embraced since the early nineties, and the ensuing debates, it is imperative that the society and general populace be objectively informed about the fundamental economic issues and the rationale for, at-times difficult, choices to be made in this regard. This could go a long way in creating an informed and harmonious democracy.

Conclusion

There is a need for banks and other agencies striving to extend financial education to the masses to appreciate that financial inclusion is a continuous process. Efforts to extend literacy to make the common man enabled by being aware of the evolving functional, legal and technical issues cannot be a one-time effort.

A common effort of the educational programmes typically focusses on the 'supply' side that stresses on attracting customers in the financial fold. However, what is needed is to have is an 'auto pilot' concept, where the prospective customer is empowered to make / demand the desired services. This could create a qualitative 'demand' situation of the financial services.

The objective of financial education is also customer protection. It helps customers to better understand and manage financial risk and deal with complexities of the market place place and take advantage of increased competition and choice in the financial sector. The RBI, on its part, intends to advance the cause of financial education in the country as part of an overall strategy. Currently, a process of credit counseling is being encouraged to help all borrowers, particularly those in distress, to overcome current financial problems and gain access to the structured financial system.

However, in the ultimate analysis financial education is only one pillar of an adequate financial policy to improve financial literacy and expand access to financial services. It can complement, but not replace other pillars such as greater transparency, policies on consumer protection and regulation of financial institutions. I do hope that in our collective interest the issues raised in this Conference are operationalised and translated into grass root level initiatives.