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Case Study

Promoting access to finance by empowering consumers - Financial literacy in developing countries

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This paper is an effort to establish the financial sector in developing countries to promote financial literacy of their customers. This could have access to finance and savings, which in turn support livelihoods, economic growth, sound financial systems, and participate in the economy. The main objectives of this paper is to enhances a bank's visibility in the communities it serves, empowering consumers to take action to improve their financial well-being, and enables consumers to make better-informed choices in the financial market is the ultimate goal. Financial literacy is critical for promoting access to finance by creating incentives and environments that promote desired financial behaviours such as saving, budgeting, or using credit wisely. Having access to savings products or insurance can greatly affect consumers' financial future, and are also likely to represent a higher share of income and thus, have a significant impact on well-being.

Key words: Banking knowledge, information and behaviour, financial future, rewards and risks.

INTRODUCTION

It is important to stress, the financial literacy program is not designed to make people financial experts, rather, the aim is to empower individuals with sufficient skills and knowledge to form financial decisions and allow them to be more in control of their circumstances. Financial literacy can help these consumers to understand their financial options, make the most of these new opportunities, and manage traditional relationships with moneylenders as well as other financial obligations.

Financial literacy is first and foremost, about empowering and enlightening consumers so that, they are knowledgeable about finance in a way that is relevant to their lives and enables them to use this knowledge to evaluate products and make informed decisions. As a consequence of the changing structure of our economy, financial knowledge has become not just a convenience but an essential survival tool. A lack of financial knowledge can contribute to the making of poor financial choices that can be harmful to both individuals and communities. Those who study financial literacy generally agree that many, if not most, consumers lack the financial literacy necessary to make important financial decisions in their own best interests (Perry, 008; Braunstein and Welch, 2002). Experts also generally agree that, financial knowledge appears to be directly correlated with self-beneficial financial behaviour (Hilgert et al., 2003). However, questions exist concerning the effectiveness of financial education in improving financial literacy (Lyons et al., 2006). Thus, a paradox exists between the efficacy of education in improving financial literacy and the impact of education on short-and long-term financial behaviour. How can education which is correlated to financial literacy improve financial behaviour without first improving financial literacy?

Mounting evidence shows that, those who are less financially literate are more likely to have problems with debt, are less likely to save, are more likely to engage in high-cost mortgages, and are less likely to plan for retirement. Without a certain level of financial literacy, consumers might not purchase the financial products and

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services they need and might be ill-equipped to fully appreciate their rights and responsibilities as financial consumers, and to understand and appropriately manage the variety of risks. The seminal work on the impact of financial education by Bernheim et al. (2001) reported that middle age individuals who took a personal financial management course in high school tended to save a higher proportion of their incomes than others who did not begun. On this situation, the impact of a course in personal financial management or personal finance may be a function of the economic environment existing at the time the course was taken.

In an attempt to reconcile the findings of Bernheim et al. (2001), which showed a positive impact on savings from high school financial education, with the Jumpstart surveys, which showed little if any impact, Mandell (2008) offered two hypotheses. The first was that some of what is learned in high school financial education classes may lie dormant in the minds of the students until much later in life when they have sufficient resources to utilize what they have learned. In this situation, a course in personal financial management or personal finance may not have an immediate impact on financial literacy until the knowledge is actually applied. In general, consumers' inability to make self-beneficial financial decisions in key areas relating to consumer financing can have negative ramifications on the entire economy.

The purpose of this paper is to offer guidance on assessing the outcomes of financial education in promoting (1) improved financial knowledge, skills and attitudes and (2) financial behaviours that lead to improved financial outcomes and, ultimately, increased assets for poor people in developing countries. At this early stage in the development of financial education for poor people in developing countries, our focus is primarily on generating information that can be useful for improving the design and delivery of financial education programs for this new target group (Sebstad et al., 2006). If financial service providers have no significant information advantage over consumers with respect to the financial products and services offered, this can weaken financial markets. Consumers are more than ever need in a certain level of financial understanding in order to evaluate and compare the increasingly voluminous and complex information available on different financial products, such as bank accounts, saving products, credit and loan options, investment vehicles, insurance coverage, etc. A survey of Washington State residents by Moore (2003) indicated that people often do not understand the terms and condition of consumer loans and mortgages.

Financially, literate consumers help to reinforce competitive pressures on financial institutions to offer more appropriately priced and transparent services, by comparing options, asking the right questions and negotiate more effectively. They also pressure government authorities to provide market standards and perform appropriate oversight of the financial system. Ultimately, financial institutions also stand to benefit, as informed clients pose less risk and constitute a market for sustainable financial services. Most of the people who are low levels of financial knowledge are not able to correctly calculate a percentage, compute compound interest correctly, and not understand interest rates or the terms of their investments. These findings are consistent with lack of financial literacy in developing countries.

These results are not promising, particularly the aging groups should have financial experience and retirement planning is relevant for this group. Lusardi and Mitchell (2006) find that older respondents display difficulty even in answering a simple question about interest rate, with the fraction of correct responses declining sharply with age. People who are financially literate are more likely to have planned for retirement. Other researchers have found that, the effectiveness of financial education seminars is low, may not reach those who are most in need of retirement planning. Developing countries must have undertaken initiatives to enhance financial literacy, with the goal of enhancing retirement security. The information that this research produces on the level of financial literacy in different subgroups in the population will be useful for efforts aimed at providing financial education and improving financial literacy.

Concepts financial literacy is essential

The current crisis has also highlighted vulnerabilities created by financial innovation and the increasing complexity of financial markets. Loan products became too complex for consumers to easily understand, and disclosure was inadequate to clarify the risks. Derivative financial products in turn became so complex that institutions trading them were also unaware of the extent of risks they were assuming. While this situation occurred in developed-country markets, these same issues are relevant for developing-country markets and for a range of financial products and providers. Developing countries are experiencing rapid growth in the financial sector, the entry of new providers and ever-more complex financial products and services, and the inclusion of new consumers to financial markets.

Bernheim (1995, 1998) was one of the first to emphasize that most individuals lack basic financial numeric knowledge. These factors, together with a likely contraction of international capital flows, increase the importance of financial literacy for consumers in poor countries. Financial literacy is especially important today for several reasons. The financial crisis will reduce access to credit and increase its cost in many developing-country markets, just as it already has in the United States and Europe. Financial literacy can help to prepare consumers for tough financial times, by promoting strategies that mitigate risk such as accumulation savings, diversifying assets, and purchasing insurance. Financial literacy also reinforces behaviours such as timely payment of bills and avoidance of over-indebtedness that help consumers to maintain their access to loans in tight credit markets.

Lusardi and Mitchell (2007c) show that, financial literacy is highly correlated with exposure to economics in school. Financial literacy is a mechanism that goes beyond political, geographic and socio-economic barriers, and it is widespread in developing countries. Financial literacy or financial education can broadly be defined as providing familiarity with and understanding of financial market products, especially rewards and risks, in order to make informed choices. Financial literacy goes beyond the provision of financial information and advice. The focus of any discussion on financial literacy is primarily on the individual, who usually has limited resources and skills to appreciate the complexities of financial dealings with financial intermediaries on a day to day basis. A large percentage of the population lacks a basic financial education, limiting their ability to make effective decisions regarding their financial future and exposing them to financial risks as well as potential market abuse. One example is offered by Hogarth et al. (2005), who demonstrated that consumers with low levels of education are disproportionately represented among the "un-banked," that is, those lacking any kind of transaction account.

The economic impact of financial literacy

In developing countries, the growing number of consumers becoming involved in newly developing financial markets and newly liberalizing economies means that some level of financial literacy will be required if these markets and economies are to expand and operate efficiently. In addition, the growth of international transactions during the last decade, resulting from new technologies and the growing international mobility of individuals, makes the issue of improving financial literacy increasingly an international concern. Financial literacy is a set of skills that serve as the entry point to basic financial knowledge. It contains a set of skills through which individuals and eventually the society in general make all–round development and actively participate in the development process through the acquisition of more knowledge, skills, capabilities and attitudes. One of the most urgent development challenges of the 21 century is, therefore, the inadequacy of better information on finance and economic terms. Information and education empower people to make changes for the betterment and improvement of their social, cultural, economic and environmental conditions. Knowledge is becoming an essential commodity for mankind, a basic raw material which is indispensable for development and even for mere survival (UNESCO, 1997).

Learning is an internal process of empowerment, an indispensable key to personal and social improvement and a development of an all-time and life-long resource and the ability to read and write allows people to acquire new knowledge, raise their level of awareness about their surrounding and understand their rights. It enables them to claim their individual and collective rights to participate in society, and participation is an important factor in development.

Financial literacy helps to improve the efficiency and quality of financial services. If financial service providers have a significant information advantage over consumers with respect to the financial products and services offered, this can weaken financial markets. Information asymmetry to the advantage of financial institutions and advisers can be very detrimental to consumers in that, they will not have the proper tools to fully appreciate their rights and responsibilities as financial consumers, the financial risks they may be exposed to, the terms and conditions of their financial products, and so forth. This can also result in suboptimal choices and decisions by consumers, choices that are most often and more costly or not appropriate for their needs (James, 2009). Financially, literate consumers help to reinforce competitive pressures on financial institutions to offer more appropriately priced and transparent services, by comparing options, asking the right questions, and negotiating more effectively.

Low financial literacy delivers poor choices

As financial markets have become increasingly complex in recent years in both developed and developing countries, more products and providers and consumers have greater responsibility for critical financial decisions such as planning for retirement (Miller, 2009). The very poor people also face an increasingly complex financial environment, due to the growth of microfinance, remittance networks, branchless banking, and micro-insurance to name just some of the financial services now available down-market. Financial literacy and basic education should be made relevant and useful to peoples' daily lives and development activities. Financial literacy must have adequate financial support to bring a substantial change in the society, and Illiterates in developing countries share those attributes that are common among peoples with high level of illiteracy: they are mostly poor and marginalized, the females being the most deprived of all the groups. The coincidence of illiteracy with poverty and deprivation is a phenomenon long realized by experts (Roy – Sing, 1990:2). The illiterates are the sector of the society that are denied their rights to education and most excluded from information and knowledge sources and opportunities.

A compelling body of survey evidence from developed countries shows that households with low levels of financial literacy tend not to plan for retirement, borrow at higher interest rates, acquire fewer assets and participate less in the formal financial system relative to their more financially-literate counterparts. The study, conducted (Bilal, Zia -2009) in collaboration with the World Bank Jakarta office, is the first such comprehensive survey of financial literacy in the developing world. In Indonesia they find that financial literacy is indeed a powerful predictor of demand for formal savings, loans and insurance services. Yet, as with any observational study, it is certainly possible that other factors explain some or all of these observed relationships. For example, individuals with lower levels of financial literacy may also have lower levels of education, be less interested in financial matters, be poorer, or have different discount rates.

Although, the effects of the financial literacy program are negligible for the general population, we do find that uneducated and financially illiterate households do benefit from such programs, in that providing such households with financial literacy education does induce them to open formal bank accounts: the likelihood of unschooled and financially illiterate household heads opening a bank savings account as a result of financial literacy training is 12 - 5%, respectively (Bilal, Zia -2009).

Knowledge: what drives demand in emerging markets?

Financial literacy is an active process, in which communicating information is only the beginning: empowering consumers to take action to improve their financial well-being is the ultimate goal. The issue of financial education is to be directly connected to the debate on access to finance, the lack of knowledge on money issues and misunderstanding the banks role. The primary focus is the provision of basic information about money and the benefits of having a relationship with a formal banking institution. Besides, financial education can contribute to a more efficient and more proactive use of scarce financial resources by current clients of banks, through a better understanding of the opportunities and options banks has to offer. It is also important to enable customers, especially the most vulnerable ones, to protect themselves from abusive financial practices and prevent them from being overburdened by debt. All in all, the end objective should be to empower people to achieve their own goals through enhancing their financial capabilities. The US Financial Literacy and Education Commission define financial literacy as "the ability to make informed judgments and to take effective actions regarding the current and future use and management of money" (Basu, 2005:1).

Financial development is widely recognized as an important determinant of economic growth (Levine (2005)). This belief has motivated substantial research on the determinants and constraints affecting the supply of banking and financial intermediation services, with substantial attention focusing on the role of institutions. Yet, the determinants of the demand for financial services are much less well understood, particularly in low-income countries. Two plausible views could explain limited demand for financial services in emerging markets. First, because these services are expensive to provide, and often involve economies of scale, it may simply be that low income individuals do not demand formal financial services. Indeed, there is evidence that informal savings, credit, and insurance markets function reasonably well in emerging markets, and the benefits of formal financial market participation may simply not exceed the relatively large fixed transactions costs associated with such products (Beck et al., 2007). An alternative view argues that, limited financial literacy serves as an important barrier to demand for services: if individuals are not familiar or comfortable with products, they will not demand them.

Financial literacy is especially important today for several reasons. The financial crisis will reduce access to credit and increase its cost in many developing-country markets, just as it already has in the United States and Europe. In a world of escalating financial complexity, there is an increasing need for financial knowledge and at least basic financial skills (Morris, 2001). Financial literacy can help to prepare consumers for tough financial times, by promoting strategies that mitigate risk such as accumulating savings, diversifying assets, and purchasing insurance. Financial literacy also reinforces behaviours such as timely payment of bills and avoidance of over-indebtedness that help consumers to maintain their access to loans in tight credit markets. Bernheim (1998) surveys several studies and shows too that workers display little financial literacy. Financial literacy can help these consumers to understand their financial options, make the most of these new opportunities, and manage traditional relationships with moneylenders as well as other financial obligations.

Technological changes and market innovation

Over the past decade, technological advances have transformed nearly every aspect of the marketing, delivery, and processing of financial products and services. The expansion of the Internet as a means of communicating and delivering services has also enabled financial services providers to market financial products and serve customers more efficiently. In Africa, traditional banking is not a viable option for many of the poor and those living in rural areas. High fees, low education and literacy, as well as long distances between banking facilities get in the way of simple transactions. Communication and delivery innovations increase the amount of information available to consumers and allow them to shop for and choose from a wide array of products and services without geographic limitation. But they are at a disadvantage because they lack access to many formal financial institutions such as banks, insurance companies, and government systems of social protection (Rutherford 2000; Lund and Srinivas, 2000).

The Philippines, South Korea and several other countries have already demonstrated the enormous potential of mobile phone banking for expanding access to financial services. But how can these success stories will be replicated in other markets, especially in developing countries where cell phone penetration is huge but where the regulatory and market environments are often very different? What lessons can be learned? What are the challenges and opportunities? The Kenyan experience with mobile phone banking is testimony to how technological innovations coupled with a supportive policy environment and appropriate oversight can expand the financial services frontier. Nevertheless, mobile banking in many other countries has not met the success recorded in Kenya. We focus on the lessons emanating from the experience of mobile banking in Kenya (Kimenyi and Ndung'u, 2009).

To benefit from the innovations, however, consumers need a base level of financial knowledge, so that they can identify and access pertinent information as well as evaluate the credibility of the source of the information. Poor people in developing countries share the same goals as all people - economic security for themselves, their families, and future generations. The main difference is that they have fewer resources and opportunities. Most live in high-risk and unpredictable environments. And, compared to others, they don't have much money (Rutherford, 2000). In this context, managing the little money that they have is vital. Good money management is critical for meeting day-to-day needs, dealing with life cycle events and unexpected emergencies, taking advantage of opportunities when they present themselves, and planning for the future.

The significance of mobile banking to the Kenyan economy is better captured by looking at the value of M-PESA transactions relative to the commercial bank deposits and also the country's GDP. In July 2007, the value of M-PESA transactions was about 0.17 percent of commercial bank deposits. In July 2009, the value of M-PESA transactions was 4.36 percent of commercial bank deposits. Kenya's annual GDP in 2008 was estimated at US$ 30.24 billion (Kimenyi and Ndung'u, 2009). Yet in July 2009, M-PESA transactions during the month of July 2009 alone accounted for US$ 535 Million. Clearly, mobile banking is a significant aspect of the Kenyan economy and this is likely to be even more important as other providers enter the market. Technological innovations have now made it possible to extend financial services to millions of poor people at relatively low cost.

Why does financial literacy matter?

The role of financial literacy has garnered increasing attention in both the developed and developing world. In January 2008, the United States government set up a President's Advisory Council on Financial Literacy, charged with promoting programs that improve financial education at all levels of the economy and helping increase access to financial services. In the developing world, the Indonesian government declared 2008 "the year of financial education." with a stated goal of improving access to and use of financial services by increasing financial literacy. Similarly, in India, the Reserve Bank of India launched an initiative in 2007 to establish Financial Literacy and Credit Counseling Centers throughout the country which would offer free financial education and counseling to urban and rural populations.

Much of this attention is motivated by a compelling body of evidence, based on household surveys in developed countries, that demonstrates a strong association between financial literacy and household well-being. Households with low levels of financial literacy tend not to plan for retirement (Lusardi and Mitchell (2007a), borrow at higher interest rates (Lusardi and Tufano (2008); Stango and Zinman (2006), acquire fewer assets (Lusardi and Mitchell (2007b), and participate less in the formal financial system relative to their more financially-literate counterparts (Alessie et al., (2007); Hogarth and O'Donnell (1999). In response to this evidence, financial literacy programs have been advanced as a low-cost intervention with the potential to improve household financial decision making and ultimately increase savings and welfare.

Challenges associated with the financial literacy

Banks of the developing countries has to face with challenges of contributing to the improvement of living conditions, supporting the local economic development and building greater social cohesion at local level is an integral part of their identity and one of their distinctive features amongst financial players. Financial education is indeed part of savings banks' wider commitment to the communities in which they operate. Banks should have a specific emphasis on the direct impact and concrete benefits on their customers by having a bank account or improving the management of one's budget or financial planning is a means to translate a theoretical presentation into a personalized, real-life case for the customers, is also defines as a financial coach for any project such as buying a home, car and a motorcycle). Poor people are like everyone else they are at a disadvantage because they lack access to many formal financial institutions such as banks, insurance companies, and government systems of social protection (Rutherford 2000; Lund and Srinivas, 2000).

This proves useful not only to provide very concrete illustration about savings, but also to disseminate basic information about responsible consumption and the risks of (easy) credit. Given that a high proportion of lower-income consumers are un-banked, there is added concern that these consumers are inadequately prepared (that is, lack of experience and information about personal finance and consumer education concepts) to make informed financial decisions (Hogarth and O'Donell, 1997).

The ability to make well-informed financial decisions plays an important part in the ability of individuals to manage their financial affairs. The outcomes of financial decisions have significant implications for an individual's financial security and standard of living. A person with a good level of financial literacy is likely to be better placed than someone without those skills and knowledge to manage their financial affairs prudently; all else being equal, they are more likely to budget effectively, invest wisely and manage their debt level in a sustainable manner. By contrast, poor financial choices, possibly based on a lack of understanding of financial matters, can result in a number of negative outcomes, including a lower level of financial wealth and imprudent debt levels. Knowledge is becoming an essential commodity for mankind, a basic raw material which is indispensable for development and even for mere survival (UNESCO, 1997).

Vision and strategy for financial literacy

To achieve this vision, a Financial Education Partnership (FEP) Kenya government has been formed bringing a number of private and public sector organizations together to champion the cause. A taskforce has been selected from the larger partnership to drive the initiative forward. In 2007, the World Bank estimated that Kenya received about $1.3 bn in remittances. About half probably was used to meet family-related expenses, with the rest going into various investments, particularly in real estate. But the financial turbulence in the UK, US and other countries will likely lead to a decline in such remittances for the near future (Kimani, 2009).

Kenya's financial sector is probably the most advanced in East Africa, yet only 55 to 60% of the population has access to financial services. Organizations such as FSD Kenya, Barclays, SIFE, Tap and Reposition Youth (TRY), and others have all contributed to the drive for financial literacy. The third Bank Windhoek Solo Banking Buzz had a 10-day successful road show in Namibia, through which Namibian youth are educated on financial literacy. 54.7% of adults in Namibia do not have bank accounts in 2007. Banks in Uganda have set up a plan to train clients on financial discipline to bring ruthless competition under control and to reduce the incidence of fraud from borrowers. Women's World Banking's gender research findings in Morocco says that women are responsible for savings for emergency and budgeting; however, most do not re-invest a lot of capital into their businesses which speaks of the need for financial literacy training. This financial education needs to empower many to improve their social status.

In addition, Citibank has been promoting financial literacy in Morocco. In Egypt, Visa, HSBC and SIFE have all launched successful responsible credit education campaign and Beecell, a Jordanian mobile services solution provider, recently announced the successful conclusion of a joint interactive SMS competition on financial literacy that targeted Zain subscribers (Jim, 2008).

RESULT AND FINDING

The importance of financial sector to the growth and development of any economy can never be over-emphasized as it could be used as the financial center of laying the foundation for the emergence of a great economy. The nature of financial centers may be such that they grew organically out of natural needs and historical developments.

Today, nearly four billion people live at the base of the economic pyramid, surviving on less than two dollars a day. A vast majority of developing countries people are excluded from access to basic financial services and knowledge that are essential for progress. To move people from being untapped and isolated members of an economic system to thriving and contributing participants requires access to financial knowledge and products. This provides people with the opportunity to become more entrepreneurial — to create economic opportunities for themselves, their families and their communities.

Competency in managing money appears to be a skill that does not come naturally to everyone. Unless a person is exposed to the practice of money management, he/she is less likely to understand how it works and its long-term benefits. It is easy to develop poor spending and financial habits resulting in significant negative consequences such as a poor credit rating, denial of credit, rejection for a checking account and bankruptcy, to name a few. Early financial literacy is the best way to prevent such consequences. Financial institutions should promote an interest in supporting or providing financial literacy programs. Relative to cost, financial literacy provides both immediate and long-term returns. The most obvious is brand recognition and market share.

Financial literacy offers an excellent opportunity to personalize ones institution among consumers who have myriad options in selecting financial service providers. Consumers who understand the merits of responsibly managing their financial resources are more likely to effectively and profitably utilize the services of a traditional financial institution. If people with low literacy make mistakes, who will pay for these mistakes? The individual or societies are large (Alesina and Lusardi, 2006).

CONCLUSION

This article has argued that financial literacy is important at many levels. It is an essential element in enabling people to manage their financial affairs and can make an important contribution to the soundness and efficiency of the financial system, and to the performance of the economy. A low level of public financial knowledge can mean that inappropriate risk return decisions are being made, and that people are not necessarily aware of the risks they face in their day-to-day financial decisions. Improved financial literacy can benefit individuals and families by giving them more control over their money and helping them make better financial decisions. Good financial literacy skills will build the capacity to better understand and manage financial risk, and take advantage of increased competition and choice in financial sectors. Broadly speaking, the purpose of financial education is to teach people concepts of money and how to manage it wisely.

The aim is to enable people to become more informed about financial decision makers, develop awareness of personal financial issues and choices, and learn basic skills related The aim is to enable people to become more informed financial decision makers, develop awareness of personal financial issues and choices, and learn basic skills related to earning, spending, budgeting, saving, borrowing, and investing money. Financial literacy can help people set financial goals and optimize their financial options.

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