# Value Added Course
# I Sem
# Basics of Financial Literacy

## ***What Is Financial Literacy?***

Financial literacy is the ability to understand and effectively use various financial skills, including personal financial management, budgeting, and investing.

When you are financially literate, you have the essential foundations of a smart relationship with money that will start a lifelong journey of learning about the financial aspects of your life. The earlier you start the better off you will be, because education is the key to success when it comes to money.

The term “financial literacy” refers to a variety of important financial skills and concepts.

People who are financially literate are generally less vulnerable to financial fraud.

A strong foundation of financial literacy can help support various life goals, such as saving for education or retirement, using debt responsibly, and running a business.

Key aspects to financial literacy include knowing how to create a budget, plan for retirement, manage debt, and track personal spending.

Financial literacy can be obtained through reading books, listening to podcasts, subscribing to financial content, or talking to a financial professional.

## ***Definitions of financial literacy***

There is a diversity of definitions used by bodies such as NGOs and think tanks, but in its broadest sense, financial literacy is an understanding of money.Some of the definitions below are closely aligned with "skills and knowledge", whereas others take broader views, and some are from academic research which is tested and validated:

- Effectively taking decisions about money management and ability to make informed decisions is called financial literacy.
- To survive in modern society individuals need to have knowledge about financial literacy
- Ability to use financial concepts in daily life and make optimal financial decisions is called financial literacy
- Financial literacy is an ability to effectively manage the economic well-being of individuals with knowledge and financial skills.
- The Government Accountability Office definition (2010) is "the ability to make informed judgments and to take effective actions regarding the current and future use and management of money. It includes the challenges associated with life events such as a job loss, saving for retirement, or paying for a child’s education."

## Understanding Financial Literacy

Financial literacy also requires the experience of financial principles and concepts, such as financial planning, compound interest, debt management, efficient investment strategies, and money-time value. Financial illiteracy can lead to poor financial choices which can have negative effects on an individual's financial well-being.

The key steps to improve financial literacy include: - Learning the skills to create a budget - Ability to track expenses - Learning the strategies to pay off debt - Planning for retirement effectively

Such measures can also include financial specialist counselling. Educating about finances involves understanding how money works, developing and achieving financial goals, and handling internal and external financial challenges.

**Benefits of Financial Literacy**

Financial literacy focuses on the ability to manage personal finance effectively, which requires experience of making appropriate personal finance choices, such as savings, insurance, real estate, college payments, budgeting, retirement and tax planning.

Those who understand finances should be able to answer questions concerning transactions, such as whether an item is required, whether it is accessible, and whether it is an asset or a liability.

This field illustrates a person's habits and perceptions towards money related to his or her daily life. The financial literacy demonstrates how an adult makes financial decisions. This expertise will help an individual build a financial road map to define their income, their expenses, and their liabilities. This subject also affects small business owners, who contribute significantly to economic growth and stability.

## ***Fundamental Components of Financial Literacy***

Financial literacy consists of several financial components and skills that allow an individual to gain knowledge regarding the effective management of money and debt.

***Below are the fundamental components of financial literacy that should be learned.***

### ***1. Budgeting***

In budgeting, there are four main uses for money that determine a budget: spending, investing, saving, and giving away.

Creating the right balance throughout the primary uses of money allows individuals to better allocate their income, resulting in financial security and prosperity.

In general, a budget should be composed in a way that pays off all existing debt while leaving money aside for saving and making beneficial investments.

### ***2. Investing***

To become financially literate, an individual must learn about key components in regards to investing. Some of the components that should be learned to ensure favorable investments are interest rates, price levels, diversification, risk mitigation, and indexes.

Learning about crucial investment components allows individuals to make smarter financial decisions that may result in an increased inflow of income.

### ***3. Borrowing***

In most cases, almost every individual is required to borrow money at one point in their life. To ensure borrowing is done effectively, an understanding of interest rates, compound interest, time value of money, payment periods, and loan structure is crucial.

If the criteria above are understood sufficiently, an individual's financial literacy will increase, which will provide practical borrowing guidelines and reduce long-term financial stress.

## *4. Taxation*

Gaining knowledge about the different forms of taxation and how they impact an individual's net income is crucial for obtaining financial literacy. Whether it be employment, investment, rental, inheritance, or unexpected, each source of income is taxed differently.

Awareness of the different income tax rates permits economic stability and increases financial performance through income management.

## *5. Personal Financial Management*

The most important criteria, personal financial management, includes an entire mix of all of the components listed above.

Financial security is ensured by balancing the mix of financial components above to solidify and increase investments and savings while reducing borrowing and debt.

Achieving an in-depth knowledge of the financial components discussed above guarantees an increase in an individual's financial literacy.

## *Scope of Financial Literacy*

Although many skills might fall under the umbrella of financial literacy, popular examples include household budgeting, learning how to manage and pay off debts, and evaluating the tradeoffs between different credit and investment products. These skills often require at least a working knowledge of key financial concepts, such as compound interest and the time value of money.

Other products, such as mortgages, student loans, health insurance, and self-directed investment accounts, have also grown in importance. This has made it even more imperative for individuals to understand how to use them responsibly.

Financial literacy can cover short-term financial strategy as well as long-term financial strategy, and which strategy you take will depend on several factors, such as your age, time horizon, and risk tolerance. Financial literacy encompasses knowing how investment decisions made today will impact your tax liabilities in the future.

This also includes knowing which investment vehicles are best to use when saving, whether for a financial goal like buying a home or for retirement. This is not to add the novelties in finance such as e-wallets, digital money, buy now/pay later, P2P lending, and other new financial products that can be convenient and cost-effective but require potential consumers to be educated to assess them adequately to their advantage.

## ***Why Financial Literacy Matters***

From day-to-day expenses to long-term budget forecasting, financial literacy is crucial for managing these factors. It is important to plan and save enough to provide adequate income in retirement while avoiding high levels of debt that might result in bankruptcy, defaults, and foreclosures.

## ***Benefits of Financial Literacy***

Being financially literate is a skill that brings forth an assortment of benefits that can improve the standard of living for individuals through an increase in financial stability.

*Listed below are the assortment of benefits of being financially literate:*

- Ability to make better financial decisions
- Effective management of money and debt
- Greater equipped to reach financial goals
- Reduction of expenses through better regulation
- Less financial stress and anxiety
- Increase in ethical decision-making when selecting insurance, loans, investments, and using a credit card
- Effective creation of a structured budget
- Making steps to becoming financially literate is an important component of life that can ensure financial solidity, reduce anxiety, and stimulate the achievement of financial goals.

### ***Strategies to Improve Financial Literacy Skills***

Developing financial literacy to improve your personal finances involves learning and practicing a variety of skills related to budgeting, managing, and paying off debts, and understanding credit and investment products. The good news is that, no matter where you are in life and financially, it's never too late to start practicing good financial habits.

***Here are several practical strategies to consider.***

### ***Create a Budget***

Track how much money you receive each month against how much you spend on an Excel sheet, on paper, or with a budgeting app. Your budget should include income (paychecks, investments, alimony), fixed expenses (rent/mortgage payments, utilities, loan payments), discretionary spending (nonessentials such as eating out, shopping, and travel), and savings.

***Pay Yourself First***

To build savings, this reverse budgeting strategy involves choosing a savings goal, such as paying for higher education, deciding how much you want to contribute toward it each month, and setting that amount aside before you divvy up the rest of your expenses.

***Pay Bills Promptly***

Stay on top of monthly bills, making sure that payments consistently arrive on time. Consider taking advantage of automatic debits from a checking account or bill-pay apps and sign up for payment reminders (by email, phone, or text).

***Get Your Credit Report***

Once a year, consumers can request a free credit report from the three major credit bureaus—Equifax, Experian, and TransUnion—through the federally created website AnnualCreditReport.com.7 Review these reports and dispute any errors by informing the credit bureau of inaccuracies. Because you can get three of them, consider spacing out your requests throughout the year to monitor yourself regularly.

***Financial Well-Being***

The definition of financial well-being that we propose is based on the consumer perspective revealed by the nearly 60 hours of open-ended interviews our research team conducted. Our research suggests financial well-being can be defined as a state of being wherein you:

Have control over day-to-day, month-to-month finances;

Have the capacity to absorb a financial shock

Are on track to meet your financial goals; and

Have the financial freedom to make the choices that allow you to enjoy life.Because individuals value different things, traditional measures such as income or net worth,while important, do not necessarily or fully capture this last aspect of financial well-being.

We then sought to identify the specific types of knowledge, behavior, and personal traits that help people achieve greater financial well-being. Our research focused on those personal drivers of well-being that may be influenced by financial education and other decision-making supports.

Of course many factors beyond an individual's control play a significant role in financial outcomes, but our research asks, "Given people's current financial circumstances, how can they make the best of their situation?"

The hypotheses we propose about key drivers of financial well-being were developed by synthesizing three methodologies in this project—literature reviews, consumer and financial practitioner interviews, and ongoing and iterative consultation with an expert panel. The hypotheses fall into three categories: financial behaviors, financial knowledge, and personal traits.

***Financial behaviors***

Four types of behaviors are hypothesized to support financial well-being:

***Effective routine money management,*** which encompasses often unconscious habits, intuitions, and decision-making shortcuts (heuristics);

***Financial research and knowledge-seeking,*** which support purposeful, informed financial decision-making;

***Financial planning and goal-setting,*** which give purpose and structure to individual financial decisions; and

***Following through on financial decisions***, the final step between intentions and desired outcomes.

People have higher levels of financial well-being when they Ask, Plan, and Act, coupled with a strong habit or tendency to live within their means in terms of their day-to-day financial choices.

***Financial knowledge***

In both published research and our interviewees' responses, we found that the link between knowledge and behavior is always affected by individual characteristics like personality, attitudes, and non-cognitive skills, and by context. Our primary hypothesis about the type of knowledge that supports financial well-being is a set of skills we call "financial ability," which encompasses:

- Knowing when and how to find reliable information to make a financial decision;
- Knowing how to process financial information to make sound financial decisions; and
- Knowing how to execute financial decisions, adapting as necessary to stay on track.

A growing consensus points toward this notion of financial ability: that in addition to a knowledge component, financial literacy has an action component—that is, the ability or skills to put financial knowledge to use.

***Personal traits***

Personal attitudes and beliefs, non-cognitive skills, and personality traits all influence financial behavior and play a role in mediating the connection between knowledge and behavior. Based on our research, we hypothesize that the following four types of personal traits are likely to affect financial well-being through their influence on behavior and/or preferences and expectations:

- Comparing yourself to your own standards, not to others (internal frame of reference);

- Being highly motived to stay on track in the face of obstacles (perseverance);
- Having a tendency to plan for the future, control impulses, and think creatively to address unexpected challenges (executive functioning); and
- Believing in your ability to influence your financial outcomes (financial self-efficacy).

## ***Importance Of Financial Literacy In Achieving Financial Stability***

As a non-profit organization focused on improving economic conditions and well-being, we recognize the critical importance of financial literacy in achieving financial stability. Here are some key points on the importance of financial literacy:

***Empowerment:*** Financial literacy empowers individuals and families to make informed decisions about their money and take control of their financial lives.

***Prevention:*** Financial literacy can help prevent individuals from falling into debt and financial insecurity, which can have long-lasting negative impacts on individuals, families, and communities.

***Education:*** Financial literacy education can help individuals understand the importance of financial planning, budgeting, saving, and investing, and how to do so effectively.

***Economic Growth:*** Financially literate individuals can contribute to economic growth and stability, as they are more likely to start and grow small businesses, invest in the stock market, and save for retirement.

***Improved Well-Being:*** Financial stability and security can lead to improved well-being, as individuals are less likely to experience stress, anxiety, and other negative mental health impacts associated with financial insecurity.

***Access to Resources:*** Financially literate individuals have better access to financial resources, such as loans and credit, which can help them achieve their financial goals.

***Sustainable Development:*** Financial literacy is critical for sustainable development, as it can help individuals and communities make informed decisions about how to allocate financial resources in a way that promotes long-term economic growth and stability.

## ***Financial Goals And Planning***

Financial goals are the personal, big-picture objectives you set for how you'll save and spend money. They can be things you hope to achieve in the short term or further down the road. Either way, it's often easier to reach your goals if you identify them in advance.

### ***Why are financial goals important?***

Financial goals are important because they can help fund your lifestyle, helping you meet both personal and professional objectives.. It's helpful to divide them into short, medium and long-term objectives. In the short term, it's helpful to reduce debt, create a savings account and create a budget that accommodates your lifestyle. In the medium and long term, it's useful to focus on financial stability and retirement planning. These are some of the benefits of creating financial goals:

- It can lead to financial freedom.
- It increases your chances of having a comfortable retirement.
- It can help you reduce or eliminate debt.
- It can help you save money for emergency situations
- It can help you and your family have a better lifestyle

## ***How To Set Financial Goals For Your Future***

Setting short-term financial goals, as well as mid-term and long-term, is an important step toward becoming financially secure. If you aren't working toward anything specific, you're likely to spend more than you should. You'll then come up short when you need money for unexpected bills, not to mention when you want to retire. You might get stuck in a vicious cycle of credit card debt and feel like you never have enough cash to get properly insured, leaving you more vulnerable than you need to be to handle some of life's major risks.

## ***Short-Term Financial Goals***

Setting short-term financial goals gives you the foundation and the confidence boost that you'll need to achieve the bigger goals that take more time. These first steps can relatively easy to achieve in as little as a year: Create a budget and stick with it. Build an emergency fund. Pay down the credit card debt that's holding you back.

## ***Midterm Financial Goals***

When you've created a budget, established an emergency fund, and paid off your credit card debt—or at least made a good dent in those three short-term goals—it's time to start working toward midterm financial goals. These goals will create a bridge between your short- and long-term financial goals.

**Financial literacy** is the possession of skills, knowledge, and behaviors that allow an individual to make informed decisions regarding money. Financial literacy, financial education and financial knowledge are used interchangeably.[1] Financially unsophisticated individuals cannot plan financially because of their poor financial knowledge. Financially sophisticated individuals are good at financial calculations; for example they understand compound interest, which helps them to engage in low-credit borrowing. Most of the time, unsophisticated individuals pay high costs for their debt borrowing

## ***Understanding Basic Financial Concepts***

### ***Money***

Money is a recognised medium of exchange in the economy. It is an asset that can be stored and used in the form of currency, or as value.

### ***Currency***

Currency is the physical form of money in the form of coins and rupees. Each country typically has its own currency as a medium of exchange, issued by the central bank. In India, the Government of India (GoI) and Reserve Bank of India (RBI) are the issuers of the currency, i.e. Indian Rupees

### ***Bank***

A bank is a government authorised financial institution which acts as a custodian of money deposited by account holders and uses the collected funds to extend loans to individuals and businesses while charging interest on the same.

***Account***

An account is a repository of the funds held by a bank on behalf of the account holder. An account can be of various kinds, and is identified by a unique account number issued to the account holder.

***Saving***

Savings is the amount of money that is remaining from income, after the expenses are made. Investment An investment refers to an asset acquired with the objective of generating income or appreciation.

***Internet Banking***

Electronic payment system that enables customers of a bank or other financial institution to conduct a range of financial transactions through the financial institution's website.

***Investing***

It means you're setting your money aside for longer – term goals. There's no guarantee that the money you invest will grow. In fact, it is normal for investments to rise and fall in value over time. But in the long run, investments can earn a lot more than you can usually make in a savings account.

***Investment in Securities Market***

Securities can be broadly classified into two types: Equities and Debts. Securities are sold in the securities market

***Primary Market*****:** Company directly issues Securities for the first time e.g. IPO (Initial Public Offer)

***Secondary Market***: Trading of securities in Stock Exchanges e.g. BSE, NSE, etc.

- ***Equity*** is a part of a company, also known as stock or share. When you buy shares of a company, you basically own a part of that company and can expect a share of profit when the company makes profits.
- ***Debt Securities*** are those instruments such as bond, debenture, promissory note etc. with a fixed amount, a maturity date and usually with a specific rate of interest. These are often less risky than equities.
- ***A Mutual Fund*** pools money from many investors and invests in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments.

## ***Investment Opportunity And Financial Products***

### 1.Banks

Bank deposits are safe investments as all bank deposits are insured upto a maximum of Rs.100,000 under the Deposit Insurance & Credit Guarantee Scheme of India. Banks are subject to control and regulated by the Reserve Bank of India. They offer various types of deposits, depending on the needs of the customer. Bank deposits are preferred more for their liquidity and safety than for the returns thereon. It is possible to get loans up to 75 - 90% of the deposit amount from banks against fixed deposit receipts.

### ***Types of Deposits***

#### ***Savings Bank Account***

As the name suggests this type of account is suitable for people who have a definite income and are looking to save money. For example, the people who get salaries or the people who work as laborers. This type of account can be opened with a minimum initial deposit that varies from bank to bank. Money can be deposited at any time in this account.

***Bank Fixed Deposit (Bank FDs)***

This type of deposit account allows the deposit to be made of an amount for a specified period. This period of deposit may range from 15 days to three years or more during which no withdrawal is allowed. However, on request, the depositor can encash the amount before its maturity. In that case, banks give lower interest than what was agreed upon. The interest on a fixed deposit account can be withdrawn at certain intervals of time. At the end of the period, the deposit may be withdrawn or renewed for a further period. Banks also grant a loan on the security of the fixed deposit receipt.

***Recurring Deposit***

While opening the account a person has to agree to deposit a fixed amount once in a month for a certain period. The total deposit along with the interest therein is payable on maturity. The account can be opened by a person individually, or jointly with another, or by the guardian in the name of a minor.

***Current Deposit Account***

Big businessmen, companies, and institutions such as schools, colleges, and hospitals have to make payment through their bank accounts. Since there are restrictions on the number of withdrawals from a savings bank account, that type of account is not suitable for them. They need to have an account from which withdrawal can be made any number of times.

## ***2. Government Schemes***

### ***Tax Savings Schemes***

The Government of India has launched Income Tax Saving Schemes including:

- National Savings Certificates (NSC)
- Public Provident Fund (PPF)
- Post Office Scheme (POS)

## ***3. Mutual Funds***

A mutual fund pools money from many investors and invests the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments. The combined holdings the mutual fund owns are known as its portfolio. Each unit represents an investor's proportionate ownership of the fund's holdings and the income those holdings generate.

Types of Mutual Funds

Each fund has a predetermined investment objective that tailors the fund's assets, regions of investments and investment strategies.

### ***Equity Funds (Stocks)***

- Fixed-income funds (bonds)
- Money market funds
- Open-ended Funds
- Closed-end Funds
- Money Market Funds
- Bond/Income Funds
- Balanced Funds
- Foreign/International Funds

***Inflation and Its Effect on Investment***

Inflation refers to rise in price of goods and services. Over time, as cost of goods and services increases, the ability of a unit of money, say one rupee or Rs.100, to buy goods and services keeps declining. In other words, Purchasing power of money decreases. It is important to take into account the effects of inflation on your investments during financial planning.

- When you are planning your investment, it is critical that you take into account the effects of inflations on your investments. At its most basic level, inflation is simply a rise in prices. Over time, as the cost of goods and services increase, the value of a rupee is going to go down because you won't be able to purchase as much with those rupees as you could have in the last month or last year.
- How does inflation affect my investment decision? A Vada pav which used to cost Rs.2 five years back now the same costs Rs.7. The cost increase is not as a result of increase in quantity or better quality. The increase is a result of increase in prices of ingredients which have increased as a result of inflation.
- Inflation is greatly feared by investors because it grinds away the value of your investment. Example:- If you invest Rs.1,000 in a one year fixed deposit that will return 5% over that year, you will be giving up Rs.1,000 right now for Rs.1,050 in 1 year. If over the course of that year there is an inflation rate of 6%, your expenses which were Rs.1,000 in the previous year will increase to Rs.1,060 at the end of the year. Thus even after investing your money for 1 year you are worse off compared to the previous year because the returns delivered by your investments has been below the inflation rate.
- What are the steps that an investor can take to avoid the adverse effects of inflation? Try to determine your "real rate of return" which is the return you can expect after factoring in the effects of

inflation. In addition to being aware of the current rate of inflation, it is crucial to be aware of what inflation rate the experts are anticipating. Both the value of current investments and the attractiveness of future investments will change depending on the outlook for inflation. Also remember fixed income investments are particularly vulnerable to the effects of inflation. If you are locked into a particular interest rate, and inflation increases your earnings will not keep up and you will earn a negative return.

***<u>Time Value of Money</u>***

- As time passes you will realise that if 10 years back you could afford to purchase a full lunch for Rs.10, today you might afford to get a few pieces of vegetables only. This means that the value of a thousand rupee note would be higher today than after five years. Although the note is the same, you can do much more with the money if you have it now because over time you can earn more interest on your money. By receiving Rs.1,000 today you are poised to increase the future value of your money by investing and gaining interest over a five year period.

- At the most basic level the time value of money demonstrates that time literally is money - the value of the money you have now is not the same as it will be in the future and vice versa.

**Management of spending and financial discipline**.

*Financial discipline is a consistent practice of spending, saving, and investing wisely to ensure effective management of financial resources and accumulate wealth in the long run. It centers on adhering to a budget, preventing debt, and achieving financial stability.* Disciplined decision-making is vital for long-term success in personal finance or business. Overspending in business can lead to debts, disorganized finances erode **investor confidence**, and, in extreme cases, result in **bankruptcy**. Hence, financial discipline is crucial for stability, growth, and resilience in both personal and **business finances**

# Financial Discipline In Business Explained

Financial discipline in business aims to manage the company's financial resources responsibly and efficiently. Some of these actions include sticking to budgetary constraints, exercising control over **expenses**, making informed financial decisions, and maintaining an equilibrium between income and expenditures.

Many companies are hiring 'behind the curve' or off-role employees to curb **human resource** expenses. Some giant businesses like Meta are reassessing their staff levels and laying off people. Whatsoever is the strategy, these firms believe that a financially disciplined organization can achieve long-term business stability and sustainability.

It plays a crucial role in resource management, identifying uncertainties, and fulfilling financial obligations for stepping towards success. It builds confidence among investors and contributes to the overall financial well-being of the business. Further, the companies can have positive cash with wise monetary decisions.

Moreover, startups with limited money in the initial stage of business can go a long way with efficient **financial management**. However, a financial plan or budget on paper is not enough to achieve long-term goals; it is essential to train employees to implement these strategies successfully. The chief financial officers (**CFOs**) of many companies are adopting innovative ways of encouraging their staff to be financially aware and responsible.

However, strict adherence to financial constraints may hinder innovation, as companies might be hesitant to invest in new and creative ventures, resulting in skipped growth opportunities in a dynamic market. This rigid approach can also hurt employee morale when deprived of certain benefits or training opportunities. Moreover, only focusing on short-term **financial goals** leads to limited **long-term investments** and strategic initiatives. These limitations may setback the company in a competitive environment.

**Some of the financial discipline tips for individuals that can help them achieve their personal finance goals and independence**:

- **Develop a Budget**: Construct a budget that clearly outlines income, **expenses**, and **savings** objectives for a comprehensive financial overview.
- **Establish Financial Goals**: Define both short-term and long-term financial objectives to provide purpose and direction for the money matter decisions.
- **Emphasize Savings**: Allocate a portion of the income towards savings before considering discretionary spending, facilitating the creation of a financial safety net.
- **Curtail Impulsive Purchases**: Adhere to the budget to mitigate immediate spending to evaluate the necessity of each expense.
- **Monitor Expenditures**: Regularly track the spending to identify areas with a scope for saving money.
- **Build an Emergency Fund**: Keep aside some money to cover unforeseen expenses, reducing reliance on **credit** during unexpected financial challenges.
- **Debt Management**: Minimize reliance on credit cards for non-essential purchases and work towards promptly repaying existing **debts**.
- **Smart Investing**: Gain knowledge on various investment options and adopt long-term strategies for **wealth accumulation**.
- **Adopt a Minimalistic Lifestyle**: Resist lifestyle improvement by spending little on **luxury items** consistently.
- **Continuous Financial Education**: Learn more about **personal finance**, **investment**, and economic trends to make well-informed financial decisions.