Impact of Financial Literacy on Saving Behaviour of Households

Monti Kumar

Assistant professor, Dept of Economics, Gangasheel Mahavidyalaya, Nawabganj Bareilly Uttar Pradesh 262407, MJPRU Bareilly

Email :- montikumar.ac.in@gmail.com

Abstract

Financial literacy has emerged as a critical determinant of household financial well-being, shaping the ability to make informed decisions on budgeting, saving, borrowing, and investing. In the context of India—where household savings are often concentrated in physical assets such as gold and real estate rather than formal financial instruments—the role of financial literacy becomes particularly important. This study investigates the effect of financial literacy on the saving behaviour of households in urban and semi-urban regions of India.

The research adopts a quantitative design, surveying 400 households selected through stratified random sampling. Financial literacy was assessed using a 10-item test covering numeracy, inflation, interest, and risk diversification, while saving behaviour was measured through savings rate and choice of instruments. Descriptive findings indicate that the average household saves 18% of its income, with 55% preferring traditional instruments and 45% using formal financial products. The mean financial literacy score was 5.8 on a 10-point scale.

Regression analysis reveals a significant positive relationship between financial literacy and household saving rates ($p < 0.01$). Households with above-average literacy (scores 6–10) saved nearly double the proportion of income compared to less literate households. However, the results also highlight important moderating factors. Gender differences show that while men score slightly higher on literacy, women display stronger preferences for safer instruments. Income constraints limit saving capacity even among financially literate low-income households, while high-income, high-literacy households exhibit more diversified portfolios.

The findings confirm that financial literacy enhances saving behaviour but is shaped by socio-economic and cultural factors. Policy recommendations include integrating financial education into school curricula, promoting community-based literacy programs, expanding digital financial literacy initiatives, and introducing automatic savings mechanisms to improve household financial resilience.

Introduction

Financial literacy has emerged as a cornerstone in the field of personal finance and household economics. It encompasses the knowledge, skills, and confidence required to make informed decisions about money management, budgeting, saving, borrowing, and investing. With the increasing complexity of financial markets, households are confronted with a wide array of products and services. Without sufficient financial literacy, individuals are at risk of making suboptimal decisions that can jeopardize their long-term financial stability.

Globally, the OECD (2020) reported that nearly 50% of adults lack a basic understanding of compound interest, risk diversification, and inflation. In developing economies, where households often operate under constrained income conditions, poor financial decisions can exacerbate cycles of poverty.

India, with its diverse socio-economic population, presents a particularly relevant case. Despite strong economic growth, household savings patterns remain fragmented, with a large proportion of savings still allocated to physical assets such as gold and real estate rather than formal financial instruments. This raises important questions about whether lack of financial literacy influences these saving choices.

Although financial literacy programs have proliferated in recent years, a substantial portion of the population continues to exhibit weak saving habits, low penetration in formal savings instruments, and vulnerability to financial shocks. While income levels are important determinants of saving behaviour, research increasingly highlights the role of financial literacy in enabling households to plan, allocate, and preserve financial resources effectively.

This study investigates: How does financial literacy affect the saving behaviour of households? By addressing this question, we contribute to ongoing debates in development economics, behavioural finance, and household studies.

Research Objectives

1. To examine the level of financial literacy among households.

2. To analyse saving behaviour patterns in relation to demographic characteristics.

3. To evaluate the relationship between financial literacy and household saving behaviour.

4. To provide policy recommendations for enhancing financial literacy and promoting savings.

Hypothesis

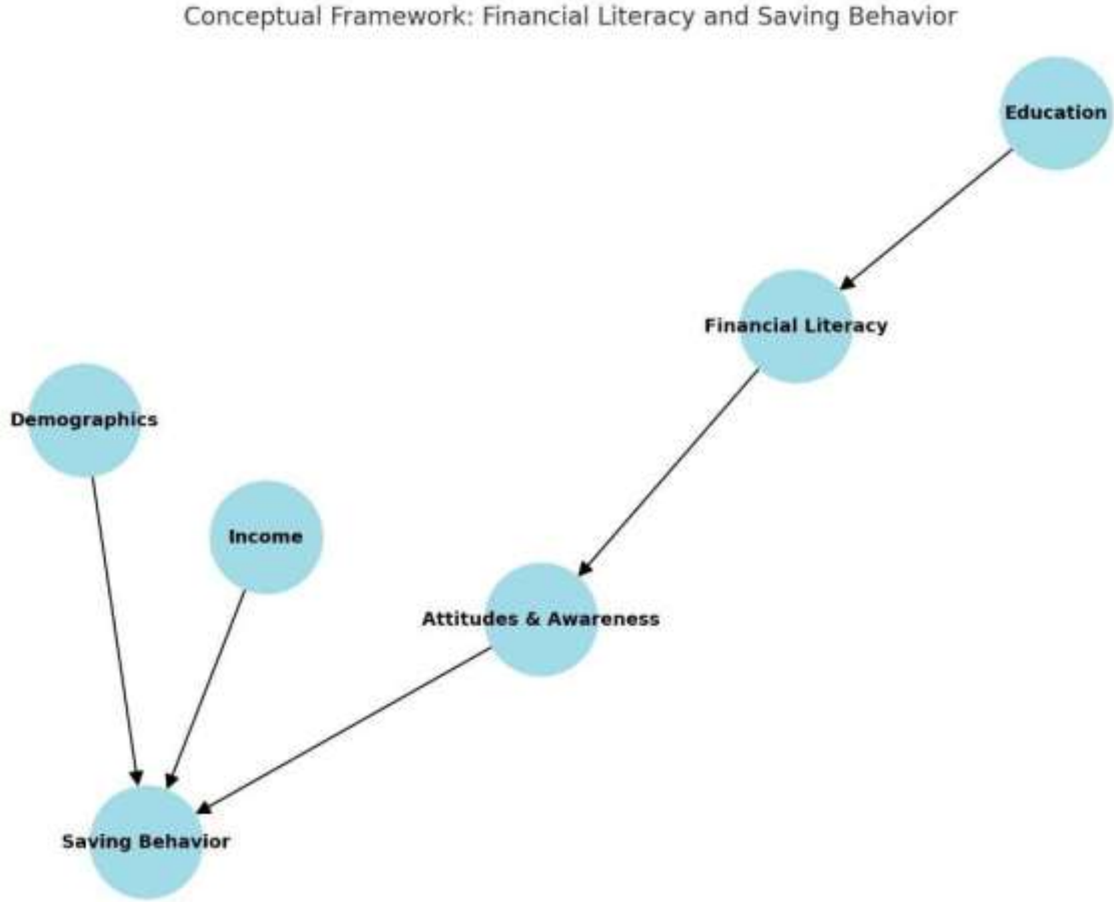
H_1: Financial literacy has a positive and significant effect on the saving behaviour of households.

H_0: Financial literacy has no significant effect on the saving behaviour of households.

Review of Literature

Conceptual Framework

Financial literacy is defined as “the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being” (OECD, 2016). It includes numeracy, budgeting, saving, borrowing, and understanding risks. Saving behaviour refers to the decisions households make about setting aside income for future use, influenced by factors like income level, cultural norms, and financial awareness.



Theoretical Perspectives

Life-Cycle Hypothesis (Modigliani & Brumberg, 1954): Households save during working years to fund retirement.

Behavioural Economics: Cognitive biases (present bias, mental accounting) often distort saving decisions.

Permanent Income Hypothesis (Friedman, 1957): Households smooth consumption based on expected lifetime income.

Empirical Studies

Lusardi & Mitchell (2007, 2014) found that U.S. households with higher financial literacy save more for retirement.

Cole, Sampson, & Zia (2011) in India showed that rural households with training were more likely to use bank accounts.

Mahdavi & Horton (2014) emphasized gender gaps, finding women less confident in financial decisions despite equal knowledge.

Atkinson & Messy (2012, OECD) highlighted the role of education in shaping savings and investment patterns.

Research Gap

While global studies confirm a literacy–savings link, there is insufficient micro-level data from Indian households, particularly semi-urban and rural segments. This study fills the gap by focusing on household-level analysis in India.

Research Methodology

The study adopts a quantitative research design using survey methods to measure financial literacy and saving behaviour among households. This approach was chosen as it enables statistical analysis of the relationships between variables, allowing for a deeper understanding of how financial literacy influences saving practices.

The target population consists of households residing in urban and semi-urban regions. From this population, a total of 400 households were selected as the sample. To ensure fair representation across different socio-economic backgrounds, a stratified random sampling technique was applied, with strata based on income, education, and occupation. This method enhances the reliability and generalizability of the findings.

Data collection involved both primary and secondary sources. Primary data were gathered through structured questionnaires designed to capture respondents' financial knowledge, attitudes, and saving practices. Secondary data were obtained from credible sources, including reports published by the Reserve Bank of India (RBI), the National Sample Survey Office (NSSO), the World Bank, and relevant scholarly research.

The study variables were carefully defined and measured. The independent variable, financial literacy, was assessed through a 10-item test covering key areas such as numeracy, inflation, interest rates, and risk diversification. The dependent variable, saving behaviour, was measured in terms of the percentage of income saved and the types of financial instruments used by households. Control variables—including age, gender, education, and income—were incorporated to account for demographic and socio-economic influences on financial literacy and savings patterns.

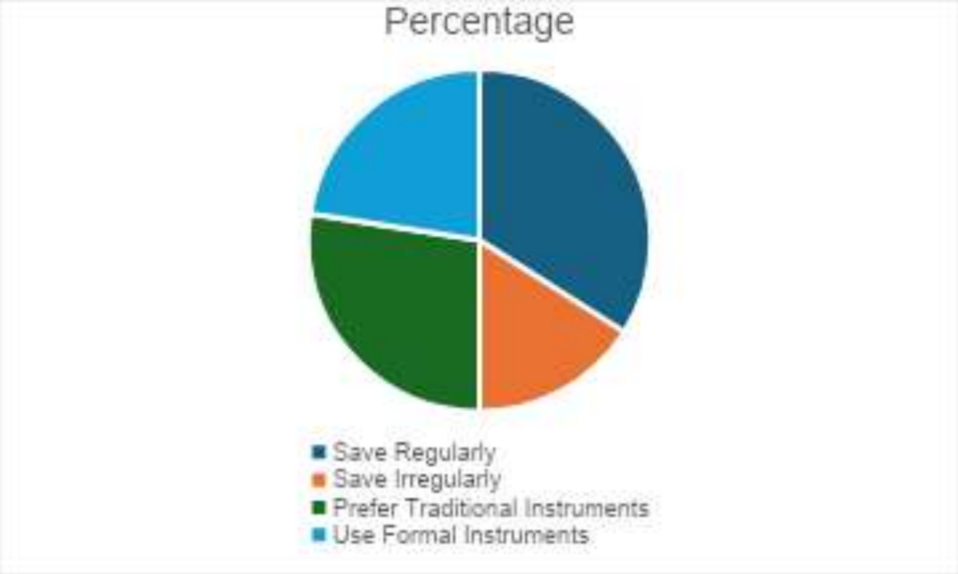
For data analysis, a range of statistical tools was employed. Descriptive statistics, including mean, standard deviation, and frequency distributions, were used to summarize the data. Correlation analysis helped to explore relationships between variables, while regression analysis was conducted to test the research hypothesis regarding the impact of financial literacy on saving behaviour. In addition, chi-square tests were applied to examine associations among categorical variables.

Analysis and Findings

- **Descriptive Statistic**

Indicator	Value
Average Household Size	5 persons
Average Monthly Income (₹)	35,000
Average Savings Rate (%)	18%
Financial Literacy Score (0–10)	5.8 (Mean)

- **Saving Patterns**



- **Gender Differences**
  Men scored slightly higher in financial literacy, but women displayed stronger preference for safe instruments (FDs, gold).

- **Relationship Between Literacy and Savings**

Financial Literacy Score	Average Saving Rate (% of Income)
Above Average (6–10)	24%
Below Average (0–5)	12%

- **Income and Literacy Interaction**
  High-income, high-literacy households used diverse portfolios (stocks, mutual funds).
  Low-income, high-literacy households still constrained by liquidity needs.

- **Important findings**

  The findings validate the hypothesis that financial literacy significantly influences saving behaviour. However, several nuances emerged:

1. Knowledge–Action Gap: Literacy does not automatically translate to action; cultural factors (gold preference) and behavioural biases persist.
2. Role of Trust: Distrust in formal institutions reduces household participation in modern financial products.
3. Income as Constraint: Even literate households may not save more if income is low, highlighting structural limitations.
4. Digital Finance Opportunity: Younger households with literacy are rapidly adopting digital wallets and UPI apps.

Conclusion and Recommendations

Conclusion

Financial literacy strongly correlates with higher savings and portfolio diversification.

Income constraints and cultural preferences moderate this relationship.

Literacy alone is insufficient; behavioural and institutional factors matter.

Policy Recommendations

Policy Recommendation	Description
Integrate financial literacy into school curricula	Introduce structured financial education at school level to build awareness early.
Promote community workshops targeting vulnerable groups	Conduct local training programs for women, low-income households, and elderly.
Encourage automatic savings mechanisms	Implement salary-linked savings, recurring deposits, and pension auto-enrollment.
Expand digital financial literacy initiatives	Use mobile apps, UPI campaigns, and gamified tools to enhance digital savings habits.

Future Research possibilities

Future research in this area could focus on several important directions. First, longitudinal tracking of financial literacy and saving behaviour over time would provide valuable insights into how knowledge acquisition translates into long-term financial habits and outcomes. Such studies could reveal whether improvements in financial literacy led to sustained changes in saving behaviour or if periodic reinforcement is necessary. Second, comparative studies across rural, urban, and semi-urban areas would help identify regional variations in saving patterns and literacy levels, allowing for more tailored policy interventions. This is particularly relevant in a country like India, where socio-economic conditions differ widely across regions. Finally, experiments with digital nudges and gamified saving tools hold promise for influencing behaviour, especially among younger and tech-savvy populations. By combining behavioural economics with digital innovation, future research can explore scalable and cost-effective ways to promote savings in diverse household settings.

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