Readings

Theoretical Readings

The democratization of finance? Promises, outcomes and conditions

Link: https://www.tandfonline.com/doi/abs/10.1080/09692290701475312

This paper analyses the 'democratization of finance' or the promise that all households can make money and/or manage risk by buying appropriate financial services products. It does so by exploring the reasons for discrepancy between what is promised and what can be delivered.

Wallerstein's insight is that capitalism is a system of inequalities which works culturally and politically through plausible rhetorics and attractive visions which enlist supporters and seduce opponents. This insight was originally intended to highlight the importance of collective reformist politics. But, we would argue that it is equally relevant to individualized money making and risk control after financialization which now partly substitutes for the collective politics of social security. Interestingly, there is already a marked discrepancy between promise and outcome with disappointment for the many after, for example, misselling of endowment mortgages and personal pensions in the UK.

If our problem is the welfare of the many, the generic Bourdieusian question is about the particular socio-economic conditions that would be necessary if the middle class masses were to fulfil the promise and participate through buying coupons in a financialized order that effectively meets their needs. We identify three key preconditions which must be satisfied: first, predictability of income and wealth effects over the life cycle of individuals and/or households; second, a basic level of consumer financial literacy and competence to select appropriate financial products and services; and, third, financial services products where risk and return are calculable.

Boosting financial literacy may be a worthwhile objective but improved literacy does not in its own right secure positive economic outcomes for individuals and households inside or outside the existing circle of investors.

"...The more credit availability expands, however, the more important financial education becomes. In this increasingly competitive and complex financial services market, it is essential that consumers acquire the knowledge that will enable them to evaluate products and services from competing providers and determine which best meet their long- and short-term needs." (Greenspan, 2005).

An alternative response to citizens' widespread lack of appropriate skills, concepts and attitudes to exercise their new rights and responsibilities comes from a group of behavioural finance academics at Wharton Business School who conclude that the solution is to simplify financial service products and structure choices in ways that recognize inertia and conservatism. (Mitchell and Utkus, 2004)

Mitchell and Utkus provide an argument about the redesign of products like pensions; our rather different aim is to explore whether the basic preconditions for democratized finance are present through three empirical questions. First, can citizens make reasonable assumptions about life cycle earnings and wealth effects within which they can plan for a definite set of contingencies? Second, is the average level of financial literacy and capacity for decision making under conditions of uncertainty sufficient to allow processing of complex information? And, third, do the savings products available have ascertainable, predictable characteristics which allow them to be used in long term savings strategies? If the answer to any of these three questions is 'no', then the basic social preconditions for felicitous outcomes have not been met.

In MacKenzie's analysis of different kinds of performativity, macro events figure as an occasional disruption or source of complexities which must be simplified by economic actors (Hardie and MacKenzie, 2006).

Like campaigns to encourage sensible drinking, financial literacy programmes may discourage but will not prevent irresponsible behaviour. Substantially increased effort and expenditure is probably justified (because reductions in gross illiteracy are highly desirable), but it is unlikely that literacy can be raised far and fast enough to justify a lighter regulatory touch. Any programmes of literacy need also to be accompanied by a re-think of the design of complex financial products to reflect the kinds of risk-return preferences and innate inertia of many consumers as discussed earlier and argued persuasively in Mitchell and Utkus (2004).

Psychological factors in consumer debt: Money management, economic socialization, and credit use

https://www.sciencedirect.com/science/article/pii/0167487095000134

Getting into, or staying out of debt is not a function of economic variables alone.

They found that an important factor in predicting debt status was whether respondents knew other people around them who were in debt, and how they thought those around them would react if they knew that the respondent was in debt. Debtors described themselves as being in a community where debt was more common and more tolerated than non-debtors.

Tokunaga (1993) found that people's reports of their parents' use of and views on credit correlated with their own ability to use credit successfully.

A specific way in which debt-tolerant, or debt-inducing norms might be generated would be if the consumer adopts an inappropriate reference group (Newcomb, 1943). If you compare yourself with people who have more economic resources than you have, and want to have, or feel entitled to the same goods and services as they enjoy, you are in obvious danger of outspending your income.

The three credit status groups were:

- **Non-debtors:** those who had had no outstanding debt to the company within the past two years;
- **Mild debtors:** those to whom a "final demand" (a second request for payment following the normal bill) had been sent at least once within the past two years, but who had paid their bill on receiving the final demand, without further action by the company;
- **Serious debtors:** those against whom court proceedings for recovery of debt had been initiated within the past two years.

Money in motion: Enabling the evolving finance sector with wealthtech

Link: https://www.ey.com/en_in/industries/wealth-asset-management/money-in-motion-enabling-the-evolving-finance-sector-with-wealthtech

India's high savings rate is influenced by cultural factors, economic conditions and the absence of a comprehensive social security system, prompting individuals and households to save significantly for future needs. Traditionally favoring physical assets like gold and real estate, the market is shifting towards financial assets, driven by better financial awareness, market returns, ease of investment management and government initiatives for financial inclusion and education.

Despite this, financial products are underpenetrated in India, with mutual funds reaching less than 5% of the working-age population.

India's investor base is diversifying, with a growing middle class and new high-net-worth individuals emerging from the startup boom and entrepreneurship. Retail investors are increasingly participating in the capital market, facilitated by digitalization, financial literacy, regulatory reforms, and accessible financial products.

Emerging trends are reshaping the wealth management landscape, presenting challenges that wealth managers must navigate to deliver value to clients, stakeholders and society. These trends include a greater emphasis on investor needs, a shift from a distribution-centric model to one focused on advisory services, the rise of 'phygital' or hybrid advisory models, outreach to previously underserved demographics, efforts to improve financial literacy and inclusion, the introduction of innovative investment products, and partnerships between agile wealthtech startups and established financial institutions. To maintain a competitive edge, wealth managers need to tailor their services to individual client needs, strengthen client relationships, provide scalable advice, develop synergistic investment opportunities, and ensure smooth client experiences.

Behavioral Finance

Link: http://www.behaviouralfinance.net/behavioural-finance.pdf

Behavioral finance is the study of the influence of psychology on the behavior of financial practitioners and the subsequent effect on markets. Behavioral finance is of interest because it helps explain why and how markets might be inefficient.

Tversky and Kahneman (1973) introduced the availability heuristic: 'a judgmental heuristic in which a person evaluates the frequency of classes or the probability of events by availability, i.e. by the ease with which relevant instances come to mind.' The reliance on the availability heuristic leads to systematic biases.

In 1974, two brilliant psychologists, Amos Tversky and Daniel Kahneman, described three heuristics that are employed when making judgments under uncertainty (Tversky and Kahneman 1974):

- **Representativeness:** When people are asked to judge the probability that an object or event A belongs to class or process B, probabilities are evaluated by the degree to which A is representative of B, that is, by the degree to which A resembles B.
- **Availability:** When people are asked to assess the frequency of a class or the probability of an event, they do so by the ease with which instances or occurrences can be brought to mind.
- **Anchoring and Adjustment:** In numerical prediction, when a relevant value (an anchor) is available, people make estimates by starting from an initial value (the anchor) that is adjusted to yield the final answer. The anchor may be suggested by the formulation of the problem, or it may be the result of a partial computation. In either case, adjustments are typically insufficient.

The most cited paper ever to appear in *Econometrica*, the prestigious academic journal of economics, was written by the two psychologists Kahneman and Tversky (1979). They present a critique of expected utility theory (Bernoulli 1738; von Neumann and Morgenstern 1944; Bernoulli 1954) as a descriptive model of decision-making under risk and develop an alternative model, which they call prospect theory. Kahneman and Tversky found empirically that people underweight outcomes that are merely probable in comparison with outcomes that are obtained with certainty; also that people generally discard components that are shared by all prospects under consideration.

In 1985 Werner F. M. De Bondt and Richard Thaler published 'Does the stock market overreact?' in the The Journal of Finance (De Bondt and Thaler 1985), effectively forming the start of what has become known as behavioral finance. They discovered that people systematically overreacting to unexpected and dramatic news events results in substantial weak-form inefficiencies in the stock market. This was both surprising and profound.

Mental accounting is the set of cognitive operations used by individuals and households to organize, evaluate and keep track of financial activities.

There is a commonly observed but unexpected negative correlation between perceived risk and perceived benefit. Finucane, et al. (2000) concluded that this was due to the affect heuristic—people tend to derive both risk and benefit evaluations from a common source.

Payment Transactions, Instruments, and Systems: A Survey

Link: https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=61aac32f6bb63fccc43a44747713c7582e537950

Market economies rely on the payment system to facilitate trade and exchange among firms and consumers in product markets. These systems also assist in transforming domestic and international savings flows into productive investments through financial markets.

Since electronic payments usually cost only one-third to one-half that of paper-based transactions, substantial savings in social costs can be realised in shifting from paper to electronic payments.

Overall, the academic literature has focused on three basic payment issues:

- The first has dealt with theoretical general equilibrium models investigating the trade-off between cash and other assets as alternative means of payment. One problem has been to explain why cash — with a positive opportunity cost — continues to be used for transactions when other assets earn a positive return.
- The second issue concerns the demand for money and the implications that substitution among different current payment media (cash, checks, and credit and debit cards) have on asset holdings (demand deposits, savings deposits, time accounts, and bonds), on money supply measurement, and on the implementation of monetary policy.
- The third issue deals with the risk of settlement failure on large-value funds transfer networks. This is the so-called systemic risk problem which generates a moral hazard for the banking system's government-provided safety net (deposit insurance and discount window borrowing).

Academic research on the second and third issues have a direct and important bearing on government policy.

The effects of technological innovations on the economy, which influence the costs of alternative transactions technologies, have been studied in a general equilibrium context by Prescott (1987), Cole and Stockman (1992), and Marquis and Reett (1994):

- For example, Prescott (1987) demonstrated that checks will be used more frequently and for larger purchases in countries that have a relatively higher cost of capital.

- The model of Cole and Stockman (1992) suggests that the probability that transactions will not be paid for with fiat money rises with a lower cost of an alternative transactions technology or with a higher nominal interest rate.
- Marquis and Reett (1994) focused explicitly on the welfare costs of inflation and on how cash management techniques that rely on costly accounting systems are used by market participants. They argue that when payment system participants alter their means of payment in order to avoid the tax that inflation imposes on cash transactions, then inflation leads to more of an economy's real resources being channeled into the payment system and into the financial sector more generally. The growth in payment and financial activities comes at the expense of output and at the expense of activities that would enhance economic growth. As a consequence, consumption is lower than it otherwise would be and a slower growth rate of the economy leads to cumulative losses over time. In sum, inflation causes a misallocation of resources towards payment system activities and a reduction in welfare.

Offsetting these benefits, cash is difficult (and expensive) to use when the amount needed for a payment is very large. Cash is also inconvenient when payment is required at a substantial distance from the payor, as occurs for most bill payments. More importantly, in countries with a relatively high crime rate, the risk of loss and/or threat to personal safety is a primary reason why users demand non-cash payment instruments. Indeed, if there was little risk of theft or loss, there would be little need to use non-cash instruments at the point-of-sale because the disadvantages of cash use — large values, distance, and loss — would be minimal while the advantages —payment finality, timeliness, and divisibility — would dominate.

While debit and credit card transactions on POS terminals can directly substitute for cash payments, ATMs make it easier to obtain cash: this can have two opposite effects on cash holdings. By making cash more accessible, ATMs would permit consumers to increase their use of cash for smaller value transactions and so may raise cash holdings. Alternatively, the greater convenience of ATMs as a way of obtaining cash may mean that consumers withdraw smaller amounts each time and make up the difference by visiting an ATM more frequently, and so may on balance reduce average cash holdings.

The demand for non-cash payment instruments is the second part of essentially a two-step nested decision process. The first step involves consumer and business demand for transaction balances while the second step involves the choice of the non-cash payment instrument which, when used, debits this balance. Because of its implications for money supply measurement, and thus the effective application of short-term monetary policy, the focus of research to date has been on the first step, not the second.

Modern market economies typically have a two-tiered banking structure through which payment services are provided:

- The first tier is composed of depository institutions (banks, savings institutions, credit co-operatives) who supply payment services to end users (consumers, financial and non-financial firms).
- The second tier includes the central bank and other payment intermediaries who often supply clearing and settlement services to banks.

Statistical Readings

Data for High income, Middle income, Low income, India

Link: https://data.worldbank.org/?locations=XD-XP-XM-IN

Inflation, Consumer Prices (Annual %) - 2023

Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly.

- High income - 4.8
- Middle income - 5.9
- Low income - 10.0
- India - 5.6

Personal Remittances, Received (% of GDP) - 2023

Personal remittances comprise personal transfers and compensation of employees. Personal transfers consist of all current transfers in cash or in kind made or received by resident households to or from nonresident households. Personal transfers thus include all current transfers between resident and nonresident individuals. Compensation of employees refers to the income of border, seasonal, and other short-term workers who are employed in an economy where they are not residents and of residents employed by nonresident entities.

- High income - 0.3
- Middle income - 1.6
- Low income - 3.2
- India - 3.4

Nearly 1 in 3 Indians middle class, to double in 25 years: Report

Link: https://timesofindia.indiatimes.com/business/india-business/middle-class-nearly-1/3rd-of-indias-population-to-be-2/3rds-by-2047-report/articleshow/95239621.cms

Indian middle class will grow from 14% in 2004-05 to as much as 46% in 2030 and 63% in 2047, says a new survey.

The share of the middle class, with an annual household income of Rs 5-30 lakh, more than doubled from 14% in 2004-05 to 31% last year, and is projected to rise to 63% by 2047, according to a survey by economic research outfit PRICE (People Research on India's Consumer Economy).

According to the report, the middle class will grow to 63% in 2047. Rajesh Shukla, MD and CEO of PRICE and author of the report, says that while much has been written on this class, defining this "middle" has always been problematic for both academicians and marketers. Lack of a universally acceptable definition, coupled with the well-known problems associated with survey data have resulted in varying estimates of its numerical estimates, says the economist who has been closely tracking the issue.

"Given that estimates range from 50 to 400 million, many question their actual strength and thus the purchasing power of this category," he says.

Selected:

- "But improved literacy does not in its own right secure positive economic outcomes for individuals and households inside or outside the existing circle of investors."
- "The more credit availability expands, however, the more important financial education becomes."

- “The solution is to simplify financial service products and structure choices in ways that recognise inertia and conservatism.”
- “Financial literacy programmes may discourage but will not prevent irresponsible behaviour.”
- “Any programmes of literacy need also to be accompanied by a re-think of the design of complex financial products to reflect the kinds of risk-return preferences and innate inertia of many consumers.”
- “Debtors described themselves as being in a community where debt was more common and more tolerated than non-debtors.”
- “People's reports of their parents' use of and views on credit correlated with their own ability to use credit successfully.”
- “...a shift from a distribution-centric model to one focused on advisory services...”
- “People systematically overreacting to unexpected and dramatic news events results in substantial weak-form inefficiencies in the stock market.”
- “Mental accounting is the set of cognitive operations used by individuals and households to organise, evaluate and keep track of financial activities.”
- “Checks will be used more frequently and for larger purchases in countries that have a relatively higher cost of capital.”
- “In countries with a relatively high crime rate, the risk of loss and/or threat to personal safety is a primary reason why users demand non-cash payment instruments.”
- “Personal remittances comprise personal transfers and compensation of employees.”
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