Financial Cognition as an Antecedent towards Financial Planning of Indian Households

MOUSUMI SINGHA MAHAPATRA*
SYED AZHER ALI**
RAM KUMAR MISHRA***

Abstract

The area of financial planning has been of research interest in India for a few years. Indian households have distinctive behaviors and attitudes towards money that can lead to suboptimal financial decisions. The present study explores the influence of financial cognition on the financial planning decisions of Indian households while considering financial cognition as a second-order component of financial attitude, risk attitude, and financial knowledge. This study explores the basic principles of subjective thinking toward financial decisions that form the financial information process. A total of 310 responses were collected and the partial least square structural equation model was to analyze and establish the model. The results of the analysis support a significant association of individuals financial cognition on their personal financial planning.

JEL Code : D1; D9
Keywords : Behavioral Finance; Financial Planning; Attitude; Cognition; Personal Finance, PLS-SEM; Household; India

I. Introduction

THE CONCEPT OF financial decision making and planning have been a research interest among the scholars of household finance (Cole, 2016). Literature on household finance support that individuals ability to take economic decisions based on assimilating financial informations depends on their cognitive ability (Delis, Galariotis and Monne, 2021; Haushofer and Fehr, 2014; Brooks and Schweitzer, 2011). Individuals’ psychological, behavioral, and cognitive

1 Presented at IPE Conference under MoU signed with IPE, Osmania University (India) in 2021

* Assistant Professor, Institute of Public Enterprise, Survey No. 1266, Shamirpet (V&M), Medchal, Hyderabad, Telangana, 500101, INDIA

** Assistant Professor, Institute of Public Enterprise, Survey No. 1266, Shamirpet (V&M), Medchal, Hyderabad, Telangana, 500101, INDIA

*** Senior Professor and Former Director, Institute of Public Enterprise, Survey No. 1266, Shamirpet (V&M), Medchal, Hyderabad, Telangana 500101, INDIA

Submitted July 2021; Accepted September 2022
References


© Indian Institute of Finance


Fornell, C., and D.F. Larcker, (1981), "Structural equation models with unobservable variables and measurement error: Algebra and statistics." Journal of Marketing Research, pp.382-388.


Mahapatra, Ali & Mishra; Financial Cognition as an Antecedent....


© Indian Institute of Finance
Annexure I

Financial Cognition The process of formation of individuals’ beliefs, attitudes, and actions towards financial thinking.

Financial Attitude Mental disposition towards the application of financial principles to manage finances.

Risk Attitude Individuals’ positive or negative state of mind towards probabilities of taking a risk in given financial situation.

Financial Knowledge Individuals’ awareness about various financial concepts, terms, and products and understanding about various financial risk and opportunities to make informed financial decisions.

Personal Financial Planning The process of planning finances for the current and future requirements and the behavior related to the implementation of the plan.

Cashflow Management The process of managing inflow and outflow of money in calculated manner as per budgets allotted to each category.

Investment Planning The process of employing the money in the different short term or long term investment avenues with a risk component and an expected rate of return. The investment avenue could include the stock market, bank/post office deposits, mutual funds, real estate, etc.

Insurance Planning The process of preparing for future financial uncertainties as a cover against risks through investing in various insurance schemes/policies. Various insurance schemes could include term plan, Endowment plan, ULIP, Money back policy, health/medical insurance, etc.

Tax Planning The process of financial planning to reduce the tax burden by investing in tax saving plans and in those schemes that yield tax advantages. Tax savings schemes could include ELSS, NPS, PPF, ULIP, etc.

Retirement Planning The process of preparing for financial security at old age through making an appropriate investment in pension plans & other financial products that give retirement solutions.

Estate Planning The process of planning for the distribution of wealth among future generations by writing a will.

Source: Self Compilation

Annexure II

<table>
<thead>
<tr>
<th>Variable</th>
<th>Construct</th>
<th>Measurement Parameters</th>
<th>References</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>Planning</td>
<td>Monitoring, Adequacy,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Behavioral Consequence,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Investment choice</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>Product ownership, Importance,</td>
<td>Adequacy, Confidence, perceived</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Return purpose</td>
<td>burden</td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td>Planning, benefits, Frequency,</td>
<td>Adequacy</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Product awareness, measures</td>
<td></td>
</tr>
<tr>
<td>Retirement</td>
<td>Awareness, return purpose,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Planning</td>
<td>Adequacy, Uncertainty, importance,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cashflow Management</td>
<td>Importance, Frequency, Adequacy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>satisfaction, Regularity, Confidence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estate planning</td>
<td>Confidence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial</td>
<td>Financial Cognition</td>
<td>Money attitude, saving attitude,</td>
<td>Moore, 1939; Edelman, 2006;</td>
</tr>
<tr>
<td></td>
<td>Attitude</td>
<td>Attitude towards credit and</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>borrowing, power, wealth</td>
<td></td>
</tr>
<tr>
<td>Risk Attitude</td>
<td>Return expectations, Risk aversion,</td>
<td>Risk-seeking, risk-neutral, Safety of returns, Adequacy of returns</td>
<td>Messick, 1976; Witkin, 1977; Greenwald &amp; Banaji, 1995; Odena (2013);</td>
</tr>
<tr>
<td>Financial Knowledge</td>
<td>Insurance Scheme, Investment options, Interest rates,</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Self Compilation

© Indian Institute of Finance