

Effect of Financial Literacy on Utilisation of Financial Services in Kaski District

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Abstract

Financial literacy is a key driver of financial inclusion, as people need the financial services that banks and other financial institutions offer. This study aims to examine the effect of financial literacy on the usage of financial services in Kaski district of Nepal. For this study, 400 sample households were chosen at a five percent margin of error, and the major decision maker for each household was chosen as the respondent. The researcher used close-ended, self-administered questionnaires to gather data. The researcher used descriptive statistics and inferential statistics such as frequency percentage distribution, exploratory factor analysis, and structural equation modelling. The study found a significant positive impact of financial literacy on the usage of financial services. This study concludes that usage of financial services among households in Kaski can be enhanced through increased financial literacy. Financial literacy programmes encourage people to use more financial services by providing adequate knowledge about financial products and services and their advantages and disadvantages. These results are very helpful to policymakers in increasing the usage of financial services through financial awareness programmes.

INTRODOUCTION AND STUDY OBJECTIVES

Financial services afforded by banks and financial institutions (BFIs) have become an integral part of modern society, as people need them to manage their finances and facilitate

transactions. Banks provide a variety of financial services like deposits, loans, credit cards, investment options, etc. Financial institutions also provide services such as insurance, investment banking, and wealth management (Iqbal, 2007). Banks and financial institutions provide financial services that assist

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people and businesses in meeting their financial requirements and achieving their financial objectives. They enable people to save money, borrow money, make payments, and invest their funds. These services also provide a means for individuals and businesses to transfer money locally and internationally. Financial services provide tools and resources for individuals to manage money effectively, save for the future, protect against risks, and make informed financial decisions. By using the financial services, individuals achieve stability, security, and peace of mind, improving overall well-being (Sethi & Acharya, 2018). Overall, financial services are crucial for the smooth operation of the economy and are necessary for individuals and businesses to manage their finances and improve overall well-being.

As financial services have become a fundamental need for people, all countries around the world have been focusing on financial inclusion and the use of financial services. However, according to the 2017 World Bank Database, financial inclusion in SAARC countries is low as compared to other regions. In SAARC, the highest percent of the population having a bank account is in India (79.9%), followed by Sri Lanka (73.6%), Bangladesh (50%), Nepal (45.4%), Pakistan (21.3%), and Afghanistan (14.9%) (Demirgüç-kunt et al., 2017).

Recognising the importance of financial inclusion, Nepal Rastra Bank, the central bank of Nepal, focused on establishing many banks and financial institutions

and providing different financial services. According to the NRB's data, there were 127 BFIs operating, of which 27 were commercial banks, 17 were development banks, 17 were finance companies, 1 was an infrastructure development bank, and 65 were microfinance financial institutions. Similar to this, there are 11,492 BFI branches as of mid-June 2022 (Nepal Rastra Bank, 2022).

The goal of financial inclusion can't be reached just by increasing the number of banks and financial institutions; people need to use financial services to reach that goal. As per the World Bank Global Findex Database 2017, the data on financial inclusion shows that the use of banks and financial institutions for savings and borrowing purposes, the use of debit and credit cards, and other financial services are also low in Nepal (Demirgüç-kunt et al., 2017).

Different factors affect the utilisation of financial services, including the financial literacy of the people (Ghosh, 2019; Morgan & Long, 2020). Financial literacy simply refers to the knowledge and skills that individuals have in managing their finances successfully. It entails comprehending financial ideas such as planning, saving, investing, borrowing, debt management, and so on. Financial literacy is important for using financial services because people who know about money are better able to make decisions about their finances and use the different financial products and services that are available to them. It also makes customers more likely to trust banks and use the financial services

they offer. The Nepalese government, through the NRB, has taken several steps over time, such as the financial literacy programmes, because it knows how important it is for everyone to benefit from financial inclusion. However, do financial literacy programmes increase awareness of financial products and services or not? Does it help to improve the usage of financial services among the people or not? are some of the questions unanswered. Hence, a study that examines how financial literacy affects the usage of financial services is needed in the specific context of Nepal. This study aims to examine the effect of financial literacy on the usage of financial services in Kaski district, Nepal. The study seeks to contribute to the understanding of the effect of financial literacy programmes in utilisation of financial services and helps to promote use of financial services through financial awareness programmes.

The research article is organised into five main sections, including an introduction, a literature review, research methods, data analysis and discussion, and conclusion and implication. Apart from this introductory part, the literature review section offers an overview of relevant concepts and previous studies concerning financial literacy, and financial inclusion. The research methods section outlines the data collection and analysis techniques employed in the study. The section on data analysis and discussion presents the outcomes derived from quantitative analysis and provides an interpretation of those findings. Lastly, the section of conclusion and implication

provides a summary of the conclusions of the study and discusses their implications.

LITERATURE REVIEW

Financial literacy

Financial literacy refers to understanding and application of financial information, skills, and theories to assist people in making rational financial choices for the betterment of their lives (OCDE, 2014). It encompasses the financial awareness, attitude, skill, and behaviour needed to make sound economic choices and achieve an individual's economic well-being (Nepal Rastra Bank, 2020). Further, financial knowledge and awareness include understanding various types of savings and loan options, mortgages, costs associated with financial services, different types of insurance, ATMs, remittances, digital financial services, etc. Financial skills include the ability to make informed decisions about appropriate bank accounts, the ability to fill out account opening forms, loan applications forms and remittance forms, determine costs and benefits from financial dealings, compute interest on loans and investments, use financial services such as ATMs and internet banking properly etc. Financial attitude includes having a positive mind-set towards saving money, keeping an interest in financial news, recognising the importance of insurance in protecting one's family, being proactive in finding ways to reduce spending, being open to taking loans from banks when necessary and being willing to use digital financial services such as ATMs and internet banking.

Financial behaviour includes having a regular saving habit, being conscious of spending and trying to spend less, having a habit of balancing income and expenses, using digital financial services like ATM and internet banking, making payments on time, regularly reviewing one's expenses, having a budget and sticking to it, avoiding unnecessary debt, and making informed financial decisions, purchasing an insurance policy to protect your family and/or assets, and maintaining adequate financial records, etc. (Nepal Rastra Bank, 2020).

Thus, increasing financial literacy can have a substantial impact on financial inclusion and the use of financial services. With greater financial knowledge and awareness, individuals are better equipped to understand the importance of formal financial services and make informed decisions about which services are appropriate for their needs. This can lead to increased participation in formal banking services and a decrease in reliance on informal financial services that may be risky or costly (Askar & Quattara, 2020).

Financial Literacy Theory of Financial Inclusion

According to the financial literacy theory of financial inclusion, education targeted at improving individuals' financial literacy is the key to attaining financial inclusion. Increasing financial knowledge will encourage people to engage in formal banking services. The theory has some benefits, such as educating people about available financial goods and services that can motivate people to take part in

formal banking services. Additionally, financial knowledge can help someone take advantage of investment and mortgage products and achieve financial freedom. Financial knowledge can also assist individuals in differentiating between needs and wants, managing budgets, saving for future expenditures, and planning for retirement. Furthermore, as a part of the national financial inclusion plan, governments with limited financial resources can prioritise financial literacy because educating the public about financial services does not require substantial public funding (Ozili, 2020). In conclusion, financial literacy is critical to achieving financial inclusion and improving economic well-being of individuals.

Financial Literacy and Financial Inclusion

Various studies have been conducted in different parts of the world on financial literacy and financial inclusion. Okello Candiya et al. (2020) investigated the link between financial knowledge and financial inclusion in 400 poor rural Ugandan families. According to the findings of the research, financial literacy has a substantial beneficial impact on financial inclusion. Further, financial knowledge and skills gained through financial literacy assist the impoverished in evaluating complex financial goods and services and making informed choices to maximise the utility of these products. In their study, Morgan and Long (2020) investigated the relationship between financial literacy, financial inclusion, and savings behaviour in Laos. The results of the study indicated that financial literacy has a significant

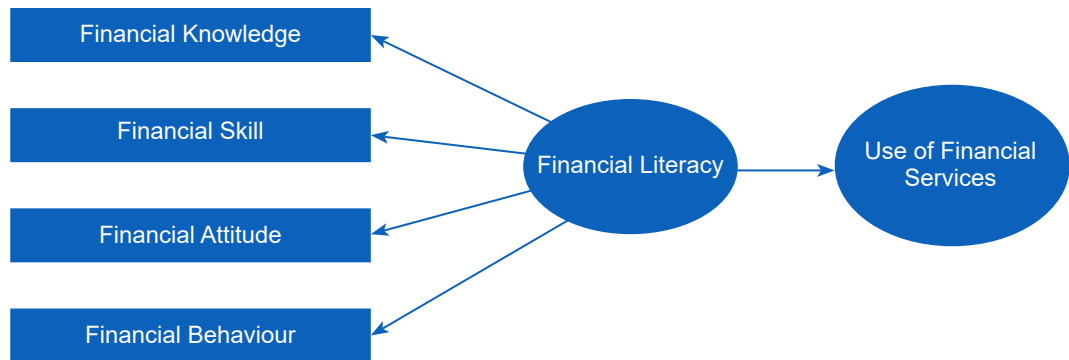


Figure 1. *Model of the Study*

positive impact on both financial inclusion and savings. The study also found that individuals with higher financial literacy scores are more inclined to save their money in both formal and informal ways, compared to those with lower financial literacy scores. Ghosh (2019) conducted a study to examine the influence of financial literacy on financial inclusion by analysing the data at household, district and macro levels. The study found that financial literacy programmes in rural areas have a more positive impact on enhancing access to bank accounts. Moreover, the study found that financial literacy programmes are more effective in promoting the utilisation of bank accounts compared to solely providing access to bank accounts. In their study, Grohmann et al. (2018) explored the association between financial literacy and financial inclusion at a national level.

The research uncovered a noteworthy positive correlation between financial literacy and all indicators of financial inclusion, including the utilisation of financial services. Rastogi and Ragabiruntha (2018) investigated the

variables influencing financial inclusion in the rural areas of India using 350 respondents. The result of exploratory factor analysis showed that financial literacy is a key driver of financial inclusion. The study also showed that the effect of financial literacy is higher in the areas where access to a formal financial system has already been reached. Agrawal (2008) argues that limited awareness and understanding of financial matters and products have led to a lack of access to financial services for certain groups of people, particularly those living in rural areas.

Thus, the previous studies cited above provide strong proof of the positive impact of financial literacy on financial inclusion. Financial literacy programmes can equip individuals with the necessary skills and knowledge to evaluate and utilise financial services effectively. Based on this, following hypothesis and research model have been developed.

H1 : Financial literacy has a significant positive impact on usage of financial services.

RESEARCH METHODS

This study employed a quantitative research design that was conducted in Kaski district, Nepal. The total number of households in the Kaski district was used as the population unit in this study, which is reported to be 120,594 (CBS Nepal, 2022). A sample of 400 households was selected using Sloven's formula for sample size determination at a five percent margin of error. In this study, the person who is primarily responsible for making major decisions in the household was chosen as the respondent. The researcher used a close-ended, self-administered questionnaire for data collection. Data was collected from both urban and rural municipalities proportionately. For data analysis, the researcher used descriptive statistics (frequency percentage distribution) and inferential statistics (exploratory factor analysis and structural equation modelling), utilising IBM SPSS Amos software.

The study initially conducted Exploratory Factor Analysis (EFA) to identify and eliminate irrelevant or unrelated items and determine the measurement items associated with each construct. Following EFA, the study proceeded with Structural Equation Modelling (SEM) to test hypotheses. The SEM consisted of a measurement model and a structural model. The measurement model was used to assess model fit, reliability, and validity of the constructs. Confirmatory Factor Analysis (CFA) was employed to evaluate model fit using indices such as CMIN/DF, GFI, NFI, CFI, and RMSEA. The

reliability of the constructs was assessed using measures like Cronbach's alpha and composite reliability. Convergent validity was examined using average variance extracted (AVE), while discriminant validity was assessed using Fornell and Larcker's Criteria. Once reliability, validity, and model fit were confirmed, the structural model was used to measure the relationship between independent variables (financial literacy) and dependent variables (utilisation of financial services).

DATA ANALYSIS AND DISCUSSIONS

Socio-demographic Characteristics of the Households

An overview of the socio-demographic characteristics of the households is presented in Table 1. It includes information on area of living, gender of the HH head, age structure, marital status, household size, family type, caste, education status, monthly income, and monthly expenditure of household.

Table 1 reveals that out of the 400 households surveyed, 84.3 percent live in a Municipality, while 15.7 percent live in a Rural Municipality. Most of the households (73.3 percent) are headed by a male. Similarly, more than half (53.5 percent) of the household heads are 41-50 years and only 7.8 percent of households have a head above 60 years of age. Regarding marital status, the majority of household heads are married (93.0 percent), while a small percentage are either unmarried (2.3 percent), divorced/single (1.8 percent), or widowed (3.0 percent). In

Table 1
Demographic Variables

Variables	Frequency (%)	Variables	Frequency (%)
Area of living		Ethnicity	
Municipality	337 (84.3)	Brahmin	199 (49.8)
Rural Municipality	63 (15.7)	Chhetri	107 (26.8)
Gender of the HH head		Janajati (Indigenous)	68 (17.0)
Male	293 (73.3)	Others	26 (6.5)
Female	107 (26.8)	Education Status	
Age structure (in years)		Illiterate	11 (2.8)
31 to 40	52 (13.0)	Literate but no formal education	23 (5.8)
41 to 50	214 (53.5)	Primary education (up to 5)	33 (8.3)
51 to 60	103 (25.8)	Lower secondary education (6 to 8)	68 (17.0)
More than 60	31 (7.8)	Secondary Education (9 to 12)	167 (41.8)
Marital Status		Higher education (Bachelor and above)	98 (24.5)
Married	372 (93.0)	Monthly Income of Household (NPR)	
Unmarried	9 (2.3)	Up to 10,000	35 (8.8)
Divorced/Single	7 (1.8)	10,001 to 40,000	177 (44.3)
Widow	12 (3.0)	40,001 to 125,000	148 (37.0)
Household size		Above 125,000	40 (10.0)
1 to 2	12 (3.0)	Monthly Expenditure of Household (NPR)	
3 to 4	170 (42.5)	Up to 10,000	41 (10.3)
5 to 6	158 (39.5)	10,001 to 20,000	122 (30.5)
7 and more	60 (15.0)	20,001 to 40,000	178 (44.5)
Family type		40,001 to 125,000	51 (12.8)
Nuclear family	267 (66.8)	Above 125,000	8 (2.0)
Joint family	133 (33.3)		
Total	400 (100.0)	Total	400 (100.0)

terms of household size, the majority of households have 3-4 members (42.5 percent), while 39.5 percent of households have 5-6 members, 15.0 percent of households have 7 or more members and only 3.0 percent households have 1-2 members. Likewise, 66.8 percent households are nuclear families, while 33.3 percent of households are joint

families. With respect to educational status, the majority of the households head (41.8 percent) have completed secondary education (grade 9-12), 24.5 percent have completed higher education (bachelor's degree and above) and only 2.8 percent are illiterate. In terms of monthly income and expenditure, the majority of the households have a

Table 2
Result of EFA

Factor	Items	Loadings	% of Variance	Cumulative %	Cronbach's Alpha
Financial Knowledge	FK4	.679	14.867	14.867	0.849
	FK5	.760			
	FK6	.710			
	FK7	.775			
	FK8	.746			
Financial Skill	FS2	.670	14.326	29.193	0.840
	FS3	.736			
	FS4	.823			
	FS5	.747			
	FS6	.616			
Usage of Financial Services	USE3	.707	12.408	41.601	0.767
	USE4	.719			
	USE5	.698			
	USE6	.702			
	USE7	.651			
Financial Behaviour	FB1	.750	10.623	52.225	0.749
	FB2	.841			
	FB3	.781			
	FB4	.503			
Financial Attitude	FA2	.676	8.174	60.399	0.616
	FA3	.780			
	FA4	.677			

monthly income of NPR 10,001 to 40,000 (44.3 percent) and monthly expenditure of NPR 20,001 to 40,000 (44.5 percent).

Exploratory Factor Analysis (EFA)

In this study, EFA was used to identify a set of latent constructs. Initially, the researcher used different 33 measurement scales (FK1 to FK9, FS1 to FS7, FA1 to FA6, FB1 to FB4, and USE1 to USE7) related to financial literacy and usage of financial services. The

suitability of factor analysis was checked with KMO with minimum acceptable value of 0.60 and Bartlett's Test having a significant at 1 % level of significance. The KMO value of 0.865 suggests that the data is highly appropriate for factor analysis, while Bartlett's test of sphericity yielded an approximate chi-square value of 3379.177 with 231 degrees of freedom and a p-value of 0.000, also indicating that the data used in the study is appropriate for factor analysis.

Likewise, commonalities of measurement scale were also checked and commonalities of minimum of 0.40 is considered. The results of commonalities of measurement scales used in the study were found more than 0.40 having range from 0.453 to 0.736. It indicates that the items are significant in factor analysis. The researcher used varimax rotation and eigenvalue greater than 1 for extraction. The final solution of EFA was achieved with 22 items, which are presented below.

Table 2 presents the result of EFA and Cronbach's alpha. Total of five factors were extracted from the EFA, which explains total of 60.399 percent of variance. The first factor – financial knowledge, comprises 5 items (FK4, FK5, FK6, FK7, and FK8) explains 14.867 percent variance. The second factor – financial skill, comprises 5 items (FS2, FS3, FS4, FS5, and FS6) explains 14.326 percent variance. The third factor – usage of financial services, comprises 5 items (USE3, USE4, USE5, USE6, and USE7) and explains 12.408 percent variance. The fourth factor –

financial behaviour comprises four items (FB1, FB2, FB3, and FB4) and explains 10.623 percent of variance. And the fifth factor – financial attitude comprises three items (FA2, FA3, and FA4) and explains 8.174 percent of total variance. Similarly, Cronbach's alpha values of all four factors are more than 0.70 which is good, and the fifth factor is 0.616 which is also acceptable.

Structural Equation Modelling (SEM)

It is used to examine the effect of financial literacy on usage of financial services. SEM includes two models. First, the confirmatory factor analysis (CFA) model is used followed by the structural Equations model.

Confirmatory Factor Analysis (CFA)

It is used to check the fitness of the proposed model. At first, the researcher used all five constructs (22 items) extracted from EFA. However, one construct – financial attitude, was found not reliable and valid. So, the final solution of CFA was achieved with four constructs and 16 items only. Different model fit indices are presented in Table

Table 3
Measurement Model Fit Indices

Indices	Criteria	Calculated Value	Comments
Absolute fit indices			
CMIN/DF	< 3 or 5	2.637	Minimum requirement is fulfilled
GFI	> 0.90	0.926	Minimum requirement is fulfilled
RMSEA	< 0.08	0.064	Minimum requirement is fulfilled
Incremental fit indices			
NFI	> 0.90	0.898	Minimum requirement is nearly fulfilled
CFI	> 0.90	0.934	Minimum requirement is fulfilled

3 as well as the validity and reliability of the constructs are presented in Table 4. Similarly, the measurement model is presented in Figure 2.

Table 3 presents the results of different fit indices. The calculated value for CMIN/DF is 2.637 which is less than 3. Similarly, the GFI value is 0.926, and CFI value is 0.934, which are more than the required value of 0.90. Likewise, NFI (0.898) is also very near to required value of 0.90 and RMSEA is 0.064, which is less than 0.08. All these results show that model is appropriate.

The measurement model in Figure 2 shows the relationship between different constructs and their indicators. Four different constructs and their indicators,

along with their loadings, are presented in the figure. Financial knowledge has five items (FK4 to FK8) with loadings ranging from 0.644 to 0.777; financial skill has four items (FS2 to FS5) with loadings ranging from 0.688 to 0.812; financial behaviour has three items (FB1 to FB3) with loadings ranging from 0.621 to 0.809; and usage of financial services has four items (USE3, USE5, USE6, and USE7) with loadings ranging from 0.546 to 0.753. The measurement model shows that all the items have good loadings (> 0.50). The items and their loadings, p-value, reliability and validity test results are presented in Table 4.

Table 4 reveals that the factor loadings of all items are larger than 0.50 and significant at 1% level of significance.

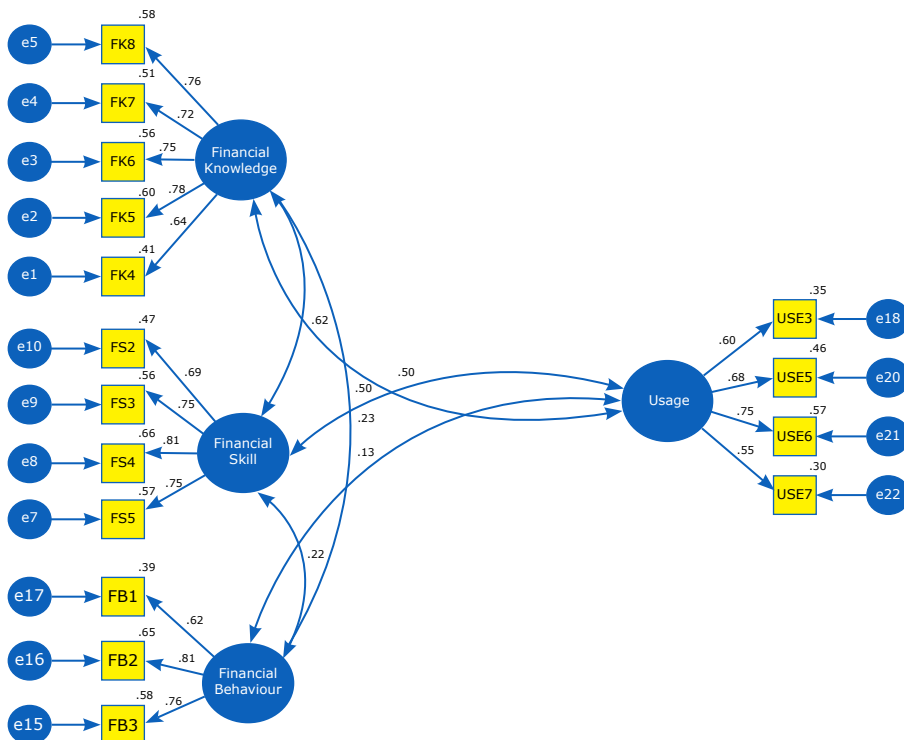


Figure 2. Measurement Model

Table 4
Result of CFA, Reliability and Validity Test

Constructs	Items	Loadings	P-value	Cronbach's Alpha	CR	AVE
Financial Knowledge	FK4	0.644	***	0.849	0.851	0.534
	FK5	0.777	***			
	FK6	0.745	***			
	FK7	0.716	***			
	FK8	0.764	***			
Financial Skill	FS2	0.688	***	0.836	0.839	0.566
	FS3	0.749	***			
	FS4	0.812	***			
	FS5	0.755	***			
	FB1	0.621	***			
Financial Behaviour	FB2	0.809	***	0.771	0.777	0.540
	FB3	0.761	***			
	USE3	0.595	***			
Usage of Financial Services	USE5	0.678	***	0.735	0.74	0.420
	USE6	0.753	***			
	USE7	0.546	***			

Similarly, the Cronbach alpha values are 0.849 for financial knowledge, 0.836 for financial skill, 0.771 for financial behaviour, and 0.735 for usage of financial service and CR values are 0.851 for financial knowledge, 0.839 for financial skill, 0.777 for financial behaviour, and 0.74 for usage of financial service which are greater than 0.70 for all. This confirms the internal consistency and reliability of the constructs.

Similarly, financial knowledge has an AVE of 0.534, financial skill has an AVE of 0.566, financial behaviour has an AVE of 0.540, and usage of financial services has an AVE of 0.420. Except for the usage, all three constructs have AVE more than the required value of 0.50. According to Hair et al. (2019), construct validity is not

an issue if the CR is more than 0.70 and the AVE is more than 0.40. Thus, this confirms the convergent validity.

Table 5 presents the results of Forenell and Lacker's Criteria. The diagonal values represent the square root of AVE and other values represent the correlation coefficient between the constructs. The table reveals that the square root of AVE of financial knowledge (0.731), financial skill (0.752), financial behaviour (0.735), and usage (0.648) are greater than the correlation values. This confirms the discriminant validity of the constructs.

Structural Model

After confirming the model fitness in measurement model, the structural model was run to see the effect of

Table 5
Discriminant Validity – Forenell and Lacker’s Criteria

	Financial Knowledge	Financial Skill	Financial Behaviour	Usage
Financial Knowledge	0.731			
Financial Skill	0.620	0.752		
Financial Behaviour	0.231	0.215	0.735	
Usage	0.496	0.499	0.132	0.648

financial literacy on usage of financial services. The fitness of structural model was also confirmed with CMIN/DF of 2.591, GFI of 0.926, NFI of 0.898, CFI of 0.934, and RMSEA of 0.063. Figure 3 shows the path diagram.

In this study, the structural model was developed based on 16 items in four different constructs, such as financial knowledge, financial skill, financial behaviour, and usage of financial services. Here, financial literacy is an

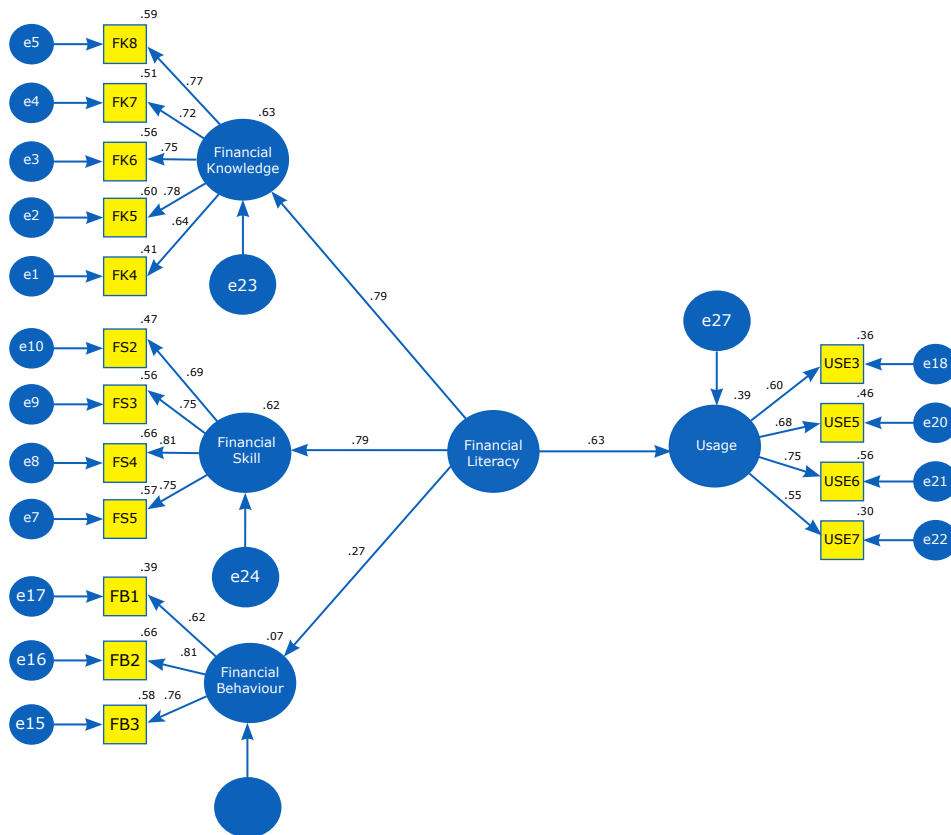


Figure 3. *Structural Model*

Table 6
Result of Path Analysis

Hypothesis	Relationship	Path Coefficient	S.E.	C.R.	P
H1	Financial Literacy -> Usage	0.627	0.576	3.697	***

exogenous variable that is determined by financial knowledge, financial skill, and financial behaviour having coefficients of 0.79, 0.79, and 0.27, respectively. Similarly, usage of financial services is an endogenous variable. Figure 3 shows the impact of financial literacy on the usage of financial services, and Table 6 presents the result of the path analysis.

Table 6 shows that financial literacy has significant positive impact on usages of financial service ($\beta = 0.627$, t-statistic = 3.697, $p < 0.001$). The findings indicate that financial literacy improves financial inclusion considerably by improving the usages of financial services in the study area. The findings are consistent with those of (Okello Candiya Bongomin et al., 2020; Grohmann et al., 2018; Ghosh, 2019, Morgan & Long, 2020), showing that financial literacy promotes financial inclusion. Financial literacy programmes offered by various organisations help people comprehend various financial products and services and assist them in selecting appropriate financial services. It also encourages people to use different financial services in order to improve their financial situation. As a result, financial literacy programmes improve financial participation and increase the use of financial services among the participants.

CONCLUSION AND IMPLICATIONS

This study has examined the effect of financial literacy on the utilisation of financial services in the Kaski district of Nepal. The study found a significant and positive effect of financial literacy on the utilisation of financial services. From the findings, it can be concluded that the utilisation of financial services in Kaski can be enhanced by increasing financial literacy. Financial literacy programmes help to improve the understanding of different financial instruments and services such as cheques, ATMs, credit cards, mobile banking, internet banking, etc. Additionally, financial literacy programmes improve individuals' ability to utilise financial services effectively, including the tasks like filling up account opening forms, loan application forms, and remittance forms as well as determining the costs and benefits from the financial dealings. These programmes also encourage people to save more and spend less, help balance income and expenses, and maintain adequate financial records. Thus, financial literacy programmes encourage individuals to utilise more financial services by providing adequate knowledge about the advantages and disadvantages of such services.

The utilisation of financial services is very important for improving the well-being of households. These results are very helpful to policymakers in increasing the usage of financial services through financial awareness programmes. The researcher suggests to the policymakers that different types of financial awareness programmes should be provided to the people to increase their awareness and usage of financial services.

This study solely concentrated on assessing the relationship between financial literacy and the utilisation of

financial services from the household perspective in the Kaski district of Nepal. Other stakeholders, such as bankers and business correspondents, were not considered in this research. Additionally, the study did not incorporate mediating and moderating variables in the proposed model. To further expand the understanding in this field, future research could involve the perspectives of other stakeholders and incorporate the effects of various mediating and moderating variables, such as financial self-efficacy, financial confidence, and demographic variables in the model.

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Conflict of interest

The author declared having no conflict of interest in the research work.

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