The Influence of Financial Literacy on Digital Lending Practices: The Moderating Effect of Financial Self-Efficacy and Risk Aversion

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Abstract

The present research looks at how consumers' borrowing habits on Indian digital lending platforms are influenced by their level of financial knowledge. It also delves into how risk aversion and financial self-efficacy impact the connection between borrowing practices and financial knowledge. A structured questionnaire and the snowball sampling technique were used to collect primary data from 357 respondents. The study's findings suggest that borrower conduct is positively impacted by financial literacy. Additionally, the study found that the association between borrowing behaviour and financial knowledge is strongly moderated by risk aversion. The three-way interaction of financial literacy, risk aversion, and financial confidence has a significant impact on the behaviour of consumers of digital lending.

Keywords: Financial literacy; Financial self-efficacy; Risk aversion; Borrowing behaviour ·

JEL Classification: C12, D14, G23

Introduction:

Using digital platforms and technology to provide financial services, especially loans, is referred as "digital lending" (Chen et al., 2023). It has fundamentally altered the loan business by making borrowing simpler, faster, more comfortable, and accessible to a larger spectrum of people. Borrowers may borrow and receive cash electronically owing to digital lending platforms, which employ web-based applications, digitised decision-making algorithms, and digital documentation(Hund et al., 2021). The rise of digital lending platforms, as well as lifestyle changes and technological advancements, has resulted in a gradual shift of consumer-bank relationships and operations. Business operations are shifting from the paradigm of consumers visiting physical institutions on their own to one in which customers have ample access to the financial services they demand via technology, such as internet and mobile banking. The last few years have witnessed the boom of financial technologies cross the globe and such technology-enabled innovations

that merge finance with information technology have quickly become a challenge to the conventional financial industry's business model.

The finance sphere is also witnessing the influence of globalization and the advancing IT, besides the trading sector. The influence of globalization and the advancing IT has given birth to new features and services, new concepts and models that are collectively referred to as financial technology or simply FinTech. Fintech enables and fosters the spread of financial services(Putri et al., 2023) . The service being discussed is provided by a company that makes it possible to lend and borrow money outside of conventional banking establishments. This service allows finding a loan workable because there are people willing to provide funding and makes it easy to draft and execute contracts electronically. This means that this service still has the ability to meet the need for funds easily and quickly and efficiently.

Financial literacy affects everyone as the number of financial products rises. People that are financially literate are able to select and utilise financial items.—such as credit cards, savings accounts, financing, mortgages, and insurance—sensibly. Even while they are more traditional and straightforward product offers, they are being supplemented by more recent financial innovations including 'crowdfunding', 'peer-to-peer lending', 'cryptocurrencies', and 'mobile payments. Diversification of portfolios is made possible by innovative financial instruments (Calvet et al., 2004).

For instance, (Law Faculty Publications et al., 2011)made the case that in order to improve societal welfare, people must make wise investments in derivative products. The majority of economies place a strong emphasis on helping people become more financially resilient(Lusardi, 2019). Therefore, by prioritising wealth growth, people with enough financial knowledge may safeguard their financial future (Kumar et al., 2023).

The capacity to comprehend economic facts and make informed decisions on debt, pensions, asset building, and financial planning is known as financial knowledge (LUSARDI & TUFANO, 2015). Lack of financial understanding may lead to a number of issues, such as making foolish purchases or failing to prepare for the future, which can result in unmanageable debt loads. People risk becoming bankrupt, losing your house to foreclosure, or having a negative credit score as a result.

The bibliometric examination of financial knowledge and financial behaviour by (Ingale & Paluri, 2022) revealed a research vacuum that this work fills. They advise utilising a variety of moderating and mediating variables to examine the connection between financial behaviour and financial literacy. Therefore, this study investigates the connection between digital lending users' borrowing behaviour and their level of financial literacy. Individual-level financial literacy research has advanced significantly. However, greater investigation is needed, particularly on how financial literacy manifests in individuals' psychological characteristics. Recent literature evaluations suggest a more in-depth study of how financial literacy affects risk-taking behaviour (Goyal & Kumar, 2021).

In addition, this study looks at how risk aversion influences the association between borrowing behaviour on digital lending platforms and financial literacy. According to (Tahir et al., 2023), higher results are obtained when financial literacy is combined with tools that facilitate planning and investing in risky but suitable securities. Likewise, according to (Bhatia & Singh, 2024), financial behaviour by itself cannot influence financial well-being. Therefore, the study looks at how risk aversion, financial self-efficacy, and financial literacy interact three ways to influence borrowing behaviour on online lending platforms.

This work significantly adds to the body of existing literature. Initially, the research contributes to the existing empirical evidence about the correlation between borrowing behaviour and financial literacy (Mirzaei & Buer, 2022). Despite various nations' efforts to enhance financial literacy, borrowing behaviours remain a significant hurdle for users (Jones & Knaack, 2019).

Young people are essential to the growth of national economies, thus it is alarming that they have a poor level of financial literacy. The state economy may benefit greatly from the efforts of young people who possess strong financial literacy. Financial literacy has been linked to

contentment, psychological wellness, and academic performance. (Folke et al., 2021) established a link between knowledge of finances, debt management.

The study demonstrates how financial education may change behaviour, including borrowing habits. Second, previous research suggests that financial literacy by itself is insufficient to support prudent financial behaviours, particularly borrowing (Sseguya et al., 2018). (Hermansson & Jonsson, 2021) suggest that individuals' resilience in the face of economic restrictions and financial emergencies, particularly in terms of risk tolerance, warrants more examination. Other important variables that might operate as moderating factors include risk aversion. One of the other elements that might influence financial behaviours, including borrowing, is risk aversion. An individual's inclination to take financial risks is reflected in their risk aversion, which can influence choices like allocating funds to safe, low-risk assets or investing in alternatives that involve more risks but have the potential for higher payouts. Borrowing behaviour is influenced by risk aversion, financial self-efficacy, and financial knowledge. Finally, the elements impacting digital lending have been highlighted in previous work. This is the first investigation on the effects of financial literacy on digital lending platform borrowers in the Indian subcontinent.

The following subsections comprise the structure of the paper. The literature review pertaining to the topics covered in this study is described in the section under "Literature review and hypothesis development". Section "Data analysis and results" provides further details on the findings and discussion, while Section "Research methodology" explains the methodology. Section "Discussion" marks the conclusion of the study.

Literature review:

Borrowing Behaviour

Materialism and consumerism are becoming prevalent among 21st century generations worldwide. There is a strong correlation between consumerism and borrowing habits, leading to increased credit utilisation (Richins, 2011). Because of the growing costs of housing, healthcare, and education, people are spending more than they make.

Middle and lower-income households frequently utilise credit cards to pay the cost of living owing to static or falling earnings (Trautmann & Kuilen, 2018), rather than overconsumption. During economic downturns, households with low or middle incomes are particularly susceptible, which can result in excessive borrowing and debt (Mahdzan et al., 2023). Low-income households, families with children, and those between the ages of 16 and 29 are particularly vulnerable to excessive debt (Venkatesh & Zhang, 2010). Consumer borrowing decisions are influenced by cognitive biases and heuristics. Individuals tend to overestimate current advantages and underestimate future expenses, leading to a preference for purchasing now and paying later to maximise consumption and happiness. According to (Kilborn, 2005), overconfidence can lead to an underestimation of bad occurrences and overborrowing.

Improper lending decisions may contribute to over-indebtedness and harm consumers' reputations, affecting their financial standing and quality of life in the long term. Over-indebted households often report poorer consumption/ income ratios than typical households due to debt payments (Betti et al., 2007). Consumers with excessive debt are prone to suffer from both mental and physical health concerns, depression-related signs, thoughts of suicide, and feelings of helplessness (Cesar Leandro & Botelho, 2022). Over-indebtedness can diminish a household's level of living and negatively impact children's well-being by not meeting their fundamental necessities. People who are overly indebted may struggle to obtain work if they become unemployed. According to (Wilde & Hsu, 2019), customers who are overly indebted may experience social marginalisation.

Financial literacy:

Many academics and organisations have varied definitions of financial literacy. The concept of financial literacy may be divided into three groups: Initially, it may be described as a fundamental comprehension of the concepts of borrowing, monetary planning, making investments, and security (Koh et al., 2020). Second, the capacity to apply financial ideas beyond basic knowledge is referred to as financial literacy (Arjun & Subramanian, 2024). Lastly, subjective financial exams that gauge people's self-

assessments of their financial literacy can be included based on earlier research (Gignac, 2022).

According to (Kadoya & Khan, 2017), financial literacy is favourably connected with education, asset balance, and financial information utilisation, but negatively correlated with financial challenges in Japan. The study found that women had a more favourable financial attitude than males, yet men are more financially knowledgeable. Age and financial expertise correlate positively, whereas age and financial attitude are negatively linked (Swiecka et al., 2020).

However, it has also been demonstrated that financial literacy negatively impacts people's perceived financial well-being (Mahdzan et al., 2023). The benefits stated above highlight the importance of financial literacy in enhancing people's financial well-being. Prior research has shown that older users in advanced nations lack the requisite financial knowledge on subjects like interest accumulation and risk diversification (Amari et al., 2020).

Consumers with sound financial knowledge are more likely to borrow money wisely and repay credit. Lack of financial awareness is one of the most common causes of overborrowing. Furthermore, according to (Annamaria Lusardi, 2015), high borrowing costs are typically linked to inadequate financial literacy. Previous research suggests that financial literacy has a significant influence, leading to the following hypothesis:

Hypothesis 1: Borrowing behaviour is positively impacted by financial knowledge.

Moderation role of risk aversion

In the relationship between financial knowledge and appropriate financial management behaviour, financial attitude serves as a full mediator and capacity for financial risk serves as a moderator (Bapat, 2020). According to (Le Fur & Outreville, 2022), students who did not take specialised financial courses were less knowledgeable about finance. The study also discovered that pupils with insufficient financial awareness exhibited risk aversion. The behavioural risk aversion of married women and men is the same, according to previous studies; nevertheless, unmarried women are more averse to behavioural risk than single men (Twumasi Baffour et al., 2019).

According to research by (Egger et al., 2020), those who are wealthy or have high incomes may bear risks because they can withstand larger losses. According to research by (Grohmann, 2018), those who are wealthy or have high incomes may bear risks because they can withstand larger losses.

Hypothesis 2: The association between borrowing behaviour and financial literacy is moderated by risk aversion. Those with high degrees of risk aversion had a less positive correlation between financial literacy and borrowing behaviour than those with low levels.

Moderating role of financial self-efficacy

According to (Nunnally, 1978), the belief that one can perform the necessary steps to accomplish certain performance objectives is known as self-efficacy. (Gentile & Soccorso, 2016) asserts that increased financial self-efficacy is associated with fewer financial concerns, decreased financial stress, financial contentment. Emerging adults with a high degree of recognised financial self-efficacy are confident in their ability to obtain facts for financial decision-making, make good judgements, and maintain solid financial management (Hadar et al., 2013).

(Morgan & Trinh, 2019) investigate the relationship between Italian financial decision makers' usage of professional financial aid, overconfidence, and financial expertise. The study found a negative correlation between overconfidence and the need for financial advice and a positive correlation between financial knowledge and financial help. Furthermore, behavioural traits like confidence have an impact on financial choices and are associated with financial literacy. Given the paucity of data supporting the combined influence of borrowing patterns, financial confidence, and financial literacy, this study postulates the following relationship:

Hypothesis 3: People with high (as opposed to low) financial self-efficacy and low (as opposed to high) risk aversion have a stronger positive relationship between financial literacy and borrowing behaviour.

Research methodology

This research uses quantitative methods. We used Google Forms to send the questionnaire to respondents in order to gather the primary data. We reached our objective of 356 respondents, with 309 (87%) responding to questionnaire statements. Cross-sectional data collected from different borrowers on online lending platforms served as a basis for this investigation. To gather information from the respondents, a snowball sampling technique derived from non-probability sampling is used. Data were collected online from September to November 2024.

Design and measurement

To test financial literacy, the three conceptions are used. Ten criteria for financial attitude were taken from the (OECD, 2023), such as "I think that knowing about financial topics is quite useful for my life." The five items in Financial Behaviour were taken from the (OECD/INFE 2023 International Survey of Adult Financial Literacy, 2023) and include statements like "I worry that I will be turned down for credit because of my credit history." According to (Koh et al., 2020), financial knowledge includes three elements, such as "Our credit rating is affected by the amount we charge on our lending patterns."

For financial behaviour, financial knowledge, and financial attitude, a seven-point Likert scale is used: 1 indicates 'strong disagreement', 2 'disagreement', 3 'slight disagreement', 4 'neutral', 5 'slight agreement', 6 'agreement', and 7 'strong agreement'.

Three items are used to evaluate risk aversion, such as "In my opinion, digital lending is too risky to consider" (Lee et al., 2023). a seven-point Likert scale is used to evaluate risk aversion: 1 indicates 'strong disagreement', 2 'disagreement', 3 'slight disagreement', 4 'neutral', 5 'slight agreement', 6 'agreement', and 7 'strong agreement'.

Borrowing behaviour is measured using 10 self-administered items, such as 'I finance the shortfall in my budget with consumer credits'. We employed descriptive and inferential statistics to analyse the data. The author utilised Smart Pls4 bootstrapping to acquire accurate results. According to (Hair et al., 2021), PLS-SEM bootstrapping provides more accurate and precise results than process (Magno et al., 2024).

Reliability and validity

"Cronbach's alpha coefficients are greater than 0.7. Reliability may be accurately predicted by Cronbach's alpha values higher than 0.7" (Nunnally, 1978). "To ascertain convergent validity, the average variance extracted (AVE > 0.50) and composite reliability (CR > 0.60) values were assessed" (Lusardi & Mitchell, 2017).

Model Fit

Using SmartPls4, model fit values are calculated. The measurement model demonstrated good fit ('Chi-square' = 2.65, 'RMSEA' = 0.05, 'SRMR' = 0.024, 'NFI' = 0.91). A number less than '0.10' or '0.08' (in a more cautious form; (Sharma et al., 2023)indicates a satisfactory match. (Li tze Hu, 1998) introduce the SRMR, a goodness-of-fit metric for PLS-SEM that helps prevent model misspecification. (Bentler & Bonett, 1980) normed fit index was a pioneering fit measure in SEM research. NFI scores above 0.9 often indicate a solid match. Figure 1 depicts the research model derived from the review of the literature.

Figure 1 Research model
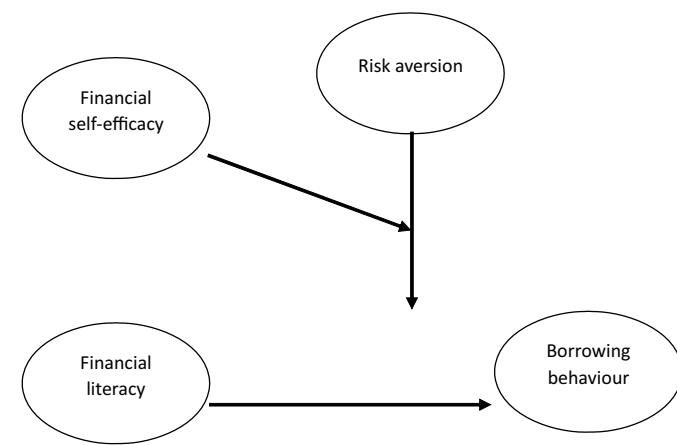
Source: Author's own compilation

Data analysis and results

Table 1 demonstrates the variable descriptions. Table 2 illustrates the demographics of the respondents. Table 3 indicates that all factors have a positive connection. Cronbach Alpha for all research variables is more than 0.70. This demonstrates the data's dependability. All settings are suitable for ensuring model fit.

Hypothesis 1: A relationship has been shown between borrowing habit and financial literacy. Financial knowledge significantly influences how people borrow money (t = 2.45 > 1.96, and P value = 0.0012). Hence, Hypothesis 1 is accepted.

Hypothesis 2: The relationship between borrowing conduct and financial literacy is moderated by risk aversion. Financial literacy and borrowing behaviour are less positively correlated with those who are very risk averse. The relationship between financial literacy and borrowing behaviour is significantly altered by risk aversion (t = 2.12, > 1.96, P = 0.004). Thus, Hypothesis 2 is supported.

Hypothesis 3. Financial knowledge and borrowing behaviour are more positively correlated among those who have low risk aversion and strong financial self-efficacy.

We investigated the influence of the three-way interaction (Table 4). The following describes the connection between borrowing conduct and risk aversion, financial literacy, and financial confidence: P = 0.054 and t = 2.65> 1.96. Consequently, Hypothesis 3 is approved. A simple slope analysis indicates that those who are financially knowledgeable, have low risk aversion, and are confident in their financial situation are more likely to borrow money thoughtfully.

Figure 2 shows a substantial moderating impact of financial literacy and risk aversion on borrowing behaviour (b = 0.44, P < 0.05) with a 95 percent confidence interval (CI) of [0.21, 1.21].

Figure 3 demonstrates that among individuals with low risk aversion and strong financial self-efficacy, financial literacy and borrowing behaviour are 'positively correlated' (b = 0.33, P < 0.05), with a 95% CI (confidence interval) of [0.07, 0.56].

Individuals with poor financial self-efficacy and high-risk aversion showed a significant positive link between financial literacy and borrowing behaviour (b = 0.27, P < 0.05, 95% confidence range [-0.07, 0.45]). The authors examined the bootstrap values.

The study found that borrowers with low risk aversion tend to have high financial confidence. Borrowers with strong risk aversion tend to have low financial confidence. Financial literacy and borrowing behaviour are strongly influenced by risk aversion and confidence.

Table 1 Variable description

Sl. No	Variable	Description
1	'Financial Literacy'	'Independent variable'
2	'Borrowing Behaviour'	'Dependent variable'
3	'Financial Confidence'	'Moderating variable'
4	'Risk Attitude'	'Moderating variable'

Source: Author's own compilation

Table 2 Demographics of participants

Demographic variables	Categories	No. of respondents	Percentage
Age	18-30	160	51.8
	31-40	82	26.5
	41-50	48	15.5
	51-60	19	6.1

Demographic variables	Categories	No. of respondents	Percentage
Gender	Male	198	64.1
	Female	111	35.9
Total		309	100.0
Education	Diploma	30	9.7
	Undergraduate	48	15.5
	Postgraduate	146	47.2
	Doctorate	56	18.1
	Others	29	9.4
Total		309	100.0
Sector	Education	85	27.5
	Financial Services	55	17.8
	IT	95	30.7
	Real Estate	18	5.8
	Service	49	15.9
	Others	7	2.3
Total		309	100.0
Employment	Government	45	14.6
	Private	214	69.3
	Self-employment	28	9.1
	Retired	22	7.1
Total		309	100.0
Salary	<30,000	36	11.7
	30,001-60,000	35	11.3
	60,001-90,000	172	55.7
	90,001-120,000	62	20.1
	> 120,001	4	1.3
Total		309	100.0

Source: Author's own compilation

Table 3 'Correlation, Mean, SD and Cronbach Alpha of the variables'

Sl. No	Variables	Mean	SD	FL	SB	FC	RA	CR	AVE
1	FL	5.25	.72	.79				.95	.81
2	SB	5.45	.79	.109*	.75			.91	.62
3	FC	6.12	.84	.127**	.512**	.71		.82	.72
4	RA	5.73	.99	.019	.462**	.654	.81	.85	.76

Source: Author's own compilation

Table 4 Results of hypothesis

| Sl. No	Hypothesis	Variable	Co-eff	T	P	Results
1	Hypothesis 1	'Financial Literacy'->'Borrowing Behaviour'	-2.36	2.78	0.015	Supported
2	Hypothesis 2	'Risk Aversion ' x 'Financial Literacy '-> 'Borrowing Behaviour' (Interaction effect 1)	.59	2.45	0.05	Supported
3	Hypothesis 3	'Financial self -efficacy 'x 'Risk Aversion ' x 'Financial Literacy'-> 'Borrowing Behaviour' (Interaction 2 : Three-way interaction)	-.16	2.05	0.034	Supported

Source: Author's own compilation

Figure 2 'Moderation effect (Simple Slope Analysis)'
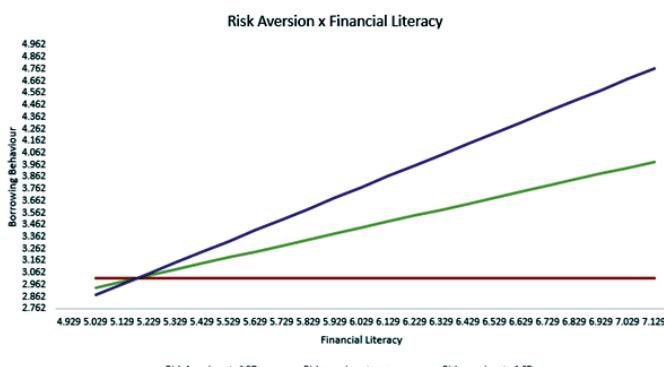
Source: Author's own compilation (Generated through SmartPLS)

**Figure 3 'Moderation effect
(three-way interaction, simple slope analysis)'**
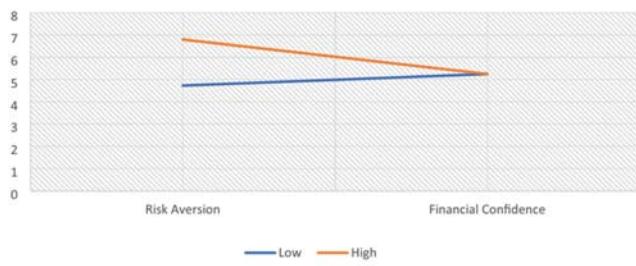
Source: Author's own compilation (Generated through SmartPLS)

Discussion

The initial goal of this research is to identify the link between financial literacy and borrowing behaviour. Financial knowledge and borrowing behaviour were revealed to be strongly correlated by Hypothesis 1. According to research, household well-being—including borrowing, investing, and saving—is impacted by financial literacy (Mpaata et al., 2023).This suggests that financial literacy leads to prudent financial behaviour among consumers. More nations are implementing national financial education strategies (Khalid et al., 2021). Borrowing behaviour is directly and favourably impacted by financial knowledge. Additionally, it was shown that the intention mediation effect was favourably significant in the connection mentioned above. This implies that deliberate borrowing behaviour, especially a propensity to minimise risks, is a result of financial system knowledge(Singh & Sharma, 2023).

This explanation pertains to the theory of financial literacy. Conventional microeconomic models make the assumption that people borrow and spend money sensibly in order to attain lifelong financial well-being. Even though there is evidence that only a small percentage of people possess this degree of financial expertise, these models believe that people have the capacity and knowledge to do so. The focus of recent studies has been on learning about finance and the connections between borrowing behaviour and knowledge (Lusardi & Mitchell, 2008).

The second objective examines how risk aversion affects the relationship between financial literacy and borrowing behaviour. Hypothesis 2 suggests that risk aversion has a moderating influence on financial literacy and borrowing behaviours. (Ingale & Paluri, 2022) found that financial literacy is an effective indicator of a person's ability to make sound financial decisions. (Grohmann, 2018) found that demographics had a substantial impact on risk aversion. Financial literacy moderates the relationship between risk aversion and borrowing behaviour.

The third objective examines the impact of Financial self-efficacy and risk aversion on borrowing behaviour.

Hypothesis 3: The interaction of financial literacy, risk aversion, and Financial self-efficacy follows: t = 2.65> 1.96, and P = 0.054 is significant for borrowing behaviour. According to (Syahwildan & Hidayah, 2024), informal labourers have poor financial literacy but strong confidence. Females were more confident in their financial knowledge than men (Cesar Leandro & Botelho, 2022) found that giving low-cost savings accounts to female microenterprise owners led to higher savings, productive investment, and expenditure on food in Kenya.

(Wilde & Hsu, 2019) found that financial knowledge affects financial behaviour and values, leading to a social exchange viewpoint and improved relationship satisfaction. Individuals' attitudes towards money influence their financial behaviour, including savings, borrowing, and risk-taking.

Additionally, there would be a lot of detrimental effects from a lack of financial literacy. According to (Twumasi Baffour et al., 2019), it may lead to costly borrowing and a significant debt load. Financial literacy has consequences for savings, borrowings and investments, and stock market involvement, as well as a considerable influence on an economy's financial and economic growth. According to (Lusardi, 2019), young people have little financial understanding, including the capacity to calculate interest rates, understand inflation, and diversify risks.

(Mpaata et al., 2023) found that financial literacy and self-control greatly influence borrowing behaviour. Furthermore, self-control influences the correlation between financial literacy and borrowing behaviour. The study found that persons with low self-control require higher levels of financial knowledge to improve their borrowing behaviour compared to those with good self-control. Financial literacy training does not significantly impact borrowing behaviour. Before receiving financial literacy instruction, people' self-control levels should be examined.

Conclusion, implications, limitations, and future research

The objectives of the research indicate a substantial link between financial literacy and borrowing behaviour. Risk aversion has a major impact on the association between financial literacy and borrowing. Financial self-efficacy has a beneficial influence on borrowing behaviour, outweighing risk aversion and financial knowledge. In recent decades, more people have access to financial goods and services. To improve financial decision-making, it's important to first examine what individuals already know and what they need to learn, and then measure the gap between the two. Most financial decisions revolve on a few core ideas (Lusardi, 2019).

The findings have significant consequences for regulators, academics, and individuals. The relevance of financial literacy in borrowing highlights the necessity for financial education programs in schools and higher institutions. This would enable better decision-making and borrowing behaviour.

Training individuals on financial literacy and borrowing behaviour is necessary. Any financial industry in India should start it. Borrowers need clear rules for future borrowing and repayments. Financial education may benefit a wide range of individuals, not only those who are comfortable with risk, as evidenced by the fact that risk aversion does not hinder its good impact.

This study presents a complex connection between independent and dependent variables due to the addition of two moderating factors. The research variables of financial behaviour, risk aversion, and financial self-efficacy will provide insight into the influence on borrowing behaviour. The three-way interaction results indicate that financial decisions are multidimensional. Policies and laws against fraudulent digital lending platforms should take into account knowledge, psychological characteristics, and confidence levels.

Despite its relevance, this study has a number of shortcomings. First, the research focusses on the Indian subcontinent. Conducting research in India is intriguing due of its enormous population and regulatory framework. Providing a questionnaire for selected responders, sent via Google Forms, proved challenging. The authors collected primary data by snowball sampling. Data collection from individual employees in India might be challenging due to their diverse nationalities. Third, we only received 309 out

of 356 replies (87%). Fourth, we used Smartpls 4. Only SRMR, NFI, and Chi-square were employed to evaluate model fit. The study's findings cannot be generalised to other countries globally.

The survey was carried out in India. The hypothesis model will be tested in emerging markets worldwide, including European and OECD nations, which is intriguing. In this work, we utilised three-way interactions. The moderated mediation or moderation model can improve understanding of borrowers from different nations by taking into account many characteristics. Financial literacy's impact varies among countries. Borrowing behaviour varies depending on risk aversion and financial confidence. This study adds to the current knowledge on financial literacy and borrowing behaviours.

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