

Chapter 11

Role of Financial Literacy in Maximizing the Impact of Decentralized Finance on Financial Inclusion

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ABSTRACT

One of the goals of international policy is financial inclusion, which may be attained by individuals who possess financial literacy and are able to make wise financial decisions. The use of financial technology and decentralized finance is one of the key factors shaping the inclusive space. This chapter aims to conduct an inclusive analysis of the role of financial literacy in maximizing the impact of decentralized finance on financial inclusion. The discussion in this chapter contributes to the emerging studies that examine the role of decentralized finance in boosting financial inclusion. Insights from this chapter can improve our understanding of the importance of financial innovation for unprivileged people and can also help regulators appreciate the nexus between fintech and financial inclusion. The chapter also provides a discussion on some difficulties that persist with implementing decentralized finance at a larger scale and how financial literacy plays a primordial role in meeting these challenges and improving how well DeFi works for people, businesses, and governments.

INTRODUCTION

Disruptive changes in digital finance led to the recent surge in decentralized finance. A specific category of finance known as “digital finance” provides consumers with

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financial services over the internet and other digital platforms. In today's digital age, new technology and innovation have enabled new and more efficient solutions and processes for traditional services. As new systems emerge, digital finance becomes more sophisticated, and by, consequent the importance of financial literacy rises. Furthermore, compared to its equivalents, financial literacy has a greater influence on disadvantaged groups' usage of digital financial services, including low-income and wealthy families, the elderly, and those living in rural regions. It is challenging for users to understand the differences, therefore shunning the inevitable change only to miss out on early adopter benefits.

The centralized banking and finance industry is being challenged by the innovative new financial technology known as DeFi. With DeFi, investors, are solely liable for their money, as opposed to traditional finance, where a business, bank, or fund is accountable for their funds. It combines several already available blockchain-related technologies, including digital assets, wallets, and smart contracts, to build a financial ecosystem ready to replace banks, brokers, exchanges, and, well, pretty much everyone and everything that currently oversees and processes financial services.

DeFi may serve as a means of achieving crucial public policy objectives such as more effective capital formation, financial inclusion, a more equitable financial system, and improved transparency. Or it can result in more negative effects than positive ones. The time has come to address these issues. The first step is to better comprehend the DeFi phenomenon.

By offering accessible, transparent, and inclusive financial services, decentralized finance has the potential to completely transform the financial industry. DeFi can close the gap in financial inclusion by leveraging its benefits of accessibility, transparency, and reduced costs to empower people and communities all around the world. Nonetheless, low level of financial literacy and financial knowledge can impact this role.

Previous studies dealt, separately, with the relationship between these three constructs: DeFi, financial literacy and financial inclusion. Some studies investigated the impact of financial literacy on financial inclusion (Hasan et al. (2020), Ghasarma et al. (2017)). Other studies were conducted to examine the impact of fintech and DeFi on financial inclusion (Hasan et al., (2021); Hasan et al., (2020b); Arner et al., (2019)). To the best knowledge of the author, limited studies assess the relationship between them. The chapter also developed a new conceptual framework linking DeFi, financial literacy and financial inclusion.

Therefore, the chapter addresses three research questions:

- 1) To what extent DeFi has increased financial inclusion ?
- 2) What are the obstacles that are still facing the DeFi ?

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