PIE - Platform for Investor Education
GFLEC - Financial Literacy -A Global Perspective

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Do you know how to calculate interest on investments? Are you aware of the impact of inflation on investment returns? Do you understand how diversification affects investment risk?

If you can answer these questions, you belong to the top one-third of the population in financial literacy, according to the S&P FinLit survey conducted by the World Bank, Gallup, and George Washington University. The survey also reveals that 76% of Indian adults cannot answer questions related to diversification, inflation, and compound interest.

Financial Literacy gives the ability to make well-informed decisions about financial choices such as saving, investing, borrowing etc. As more and more governments are working to boost access to financial services it is becoming more critical to understand finance. Ignoring it could result in heavy losses such as paying higher transaction fees, paying back debts higher amount of debt than required, and incur higher interest rates and also borrow more and save less.

Financial literacy requires knowing about borrowing and credit cards it also implies that you become aware of equities and mutual funds. The following sections explain the importance of financial literacy.

"Financial Literacy in Indian Adults is just 24%"

Compared to developed economies, major emerging economies, the BRICS that is Brazil, the Russian Federation, India, China and South Africa, an average of only 28% of adults are financially literate (Figure 1). Even within these countries, there is disparity with 24% in India to 42% in South Africa and 26% in Pakistan.

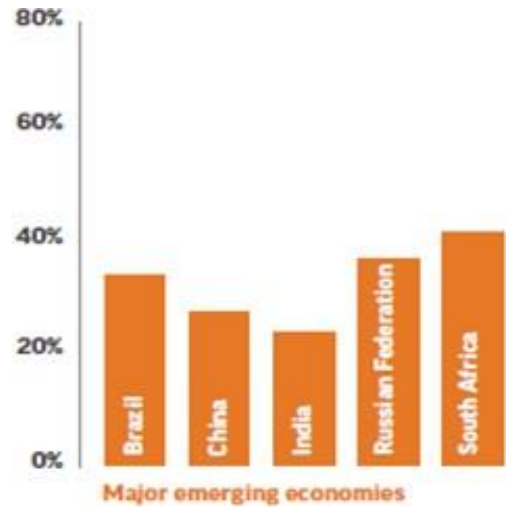

Figure 1

"Just 11% of adults in Emerging Economies use Credit Cards"

Credit is much more common in major economies than in emerging economies. In other major economies, 51% of adults use credit cards while only 11% of adults in the major emerging economies use credit cards. In India, there are unofficial, non-bank borrowing sources that may not be reflected in these number. 53% of adults using credit cards or borrowing from a financial institution are financially literate. This is much higher than the average financial literacy rate of their economies. Though credit cards are gaining popularity in emerging economies, required financial knowledge is not increasing. In emerging economies such as Brazil, 32% of them use credit cards, but 40% are financially literate and only half answer compound interest question correctly (Figure 2).

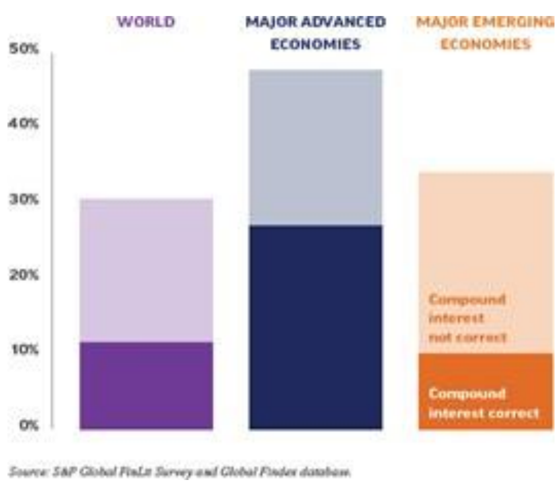

Figure 2

"Only 28.4% of Indian Adults are aware of Equities and Mutual Funds"

Based on World Bank Data of 2017, India is among the top-20 saver countries with a saving rate of 30.2%. With such a savings rate, what are Indians doing when it comes to investing these savings? SEBI Investor Survey (SIS) 2015 gives a glimpse of investor patterns and awareness in India. It explains the behaviour and extent of awareness on finance that the Indian public has. The SIS report explains that there is a difference between awareness in savings schemes and investment instruments. Awareness in saving schemes is much higher.

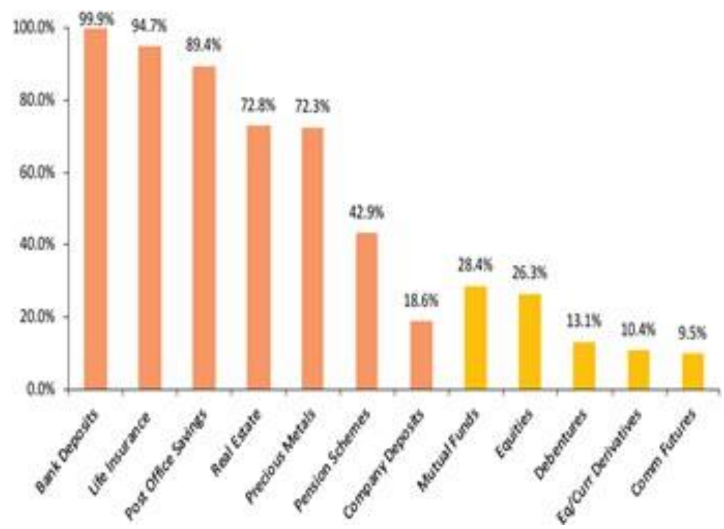

Figure 3

While awareness concerning company, deposits is lower than that of mutual funds or equities, familiarity with every other savings scheme and non-market instruments is significantly higher than that of any of the market instruments. Additionally, although nearly all the survey participants are staggeringly aware of Bank Deposits (99.9 per cent), Life Insurance (94.7 per cent) and Post Office Savings (89.4 per cent), familiarity with Mutual Funds and Equities is just 28.4 per cent and 26.3 per cent, respectively.

Figure 4

In fact, the "Mutual Funds Sahi Hai" campaign has brought about a big increase of 33% in average AUM for the Indian Mutual fund industry from Feb 2017 to March 2019. Over the last decade, the Indian mutual fund industry has grown 5.5 fold.

On the other hand, Figure 4, awareness of Derivatives (10.4 per cent) and Futures (9.5 per cent) is even lower and surprisingly, Debentures (13.1 per cent), despite being fixed income investments with a declared interest rate, ranks low too.

Looking further into the household while awareness of Investment Instruments, savings instruments are almost identical amongst investors and non-investors, familiarity with investment instruments is extremely low amongst non-investors.

Awareness of even traditional investments like equities and mutual funds is surprisingly low among non-investors while awareness of derivatives, bonds and debentures are in the single digits. This data shows that there is a need to reach out and educate a wider populace about choices available in the securities markets and stressing the benefits of diversification, risk management and returns optimization to create a more efficient household financial portfolio.

To further investigate the specific motivations that govern a household's investing preferences, the SIS 2015 closely scrutinized their decision-making and investment rationale.

Capital gains, Figure 5, which are "… an increase in the value of a capital asset (investment or real estate) that gives it a higher worth than the purchase price" [1], is the primary purpose for household investing. Thus, capital gains closely followed by lifestyle improvement are the key motivations for investing while liquidity needs and home buying also play crucial roles.

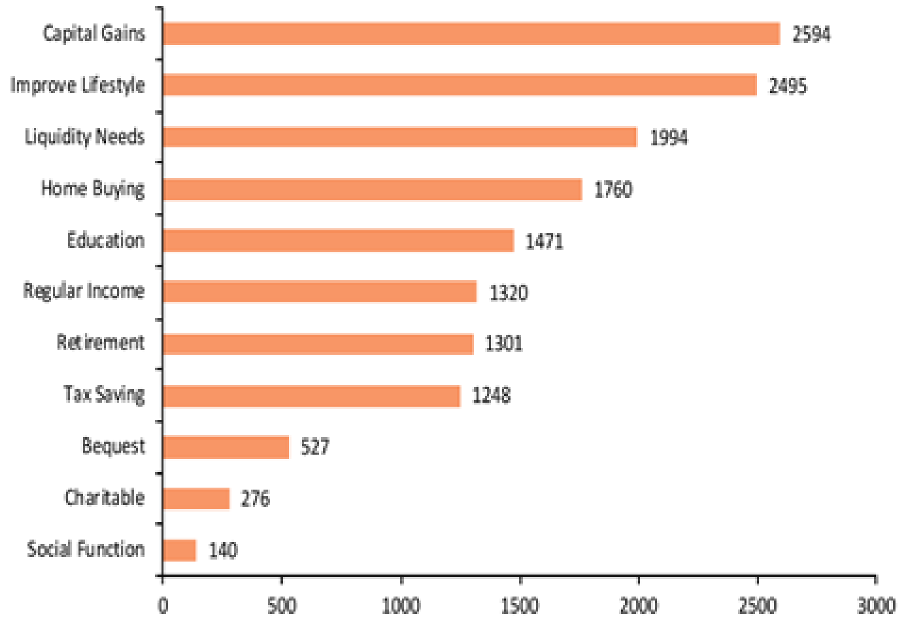

Figure 5

According to the SEBI investor survey about 15 Percent of survey respondents participate in securities markets. Household awareness of savings schemes is significantly higher than of other investment instruments. Middle-income groups save more as a percentage of their annual income than the highest income groups. The SIS data finds that even among households that invest, it is education and occupation and not factors such as age, household size or marital status that are the primary drivers. Most investors (66 Percent) invest in mutual funds rather than equities (55 Percent). Lower-income groups tend to invest more in debt instruments. There is also a direct linear correlation between higher education levels and superior portfolio diversification.

According to data from the RBI, Figure 6, since 2000, the investment in Bank Deposit has consistently increased. Other Financial Assets, including Life Insurance, have remained the same over the past 20 years.

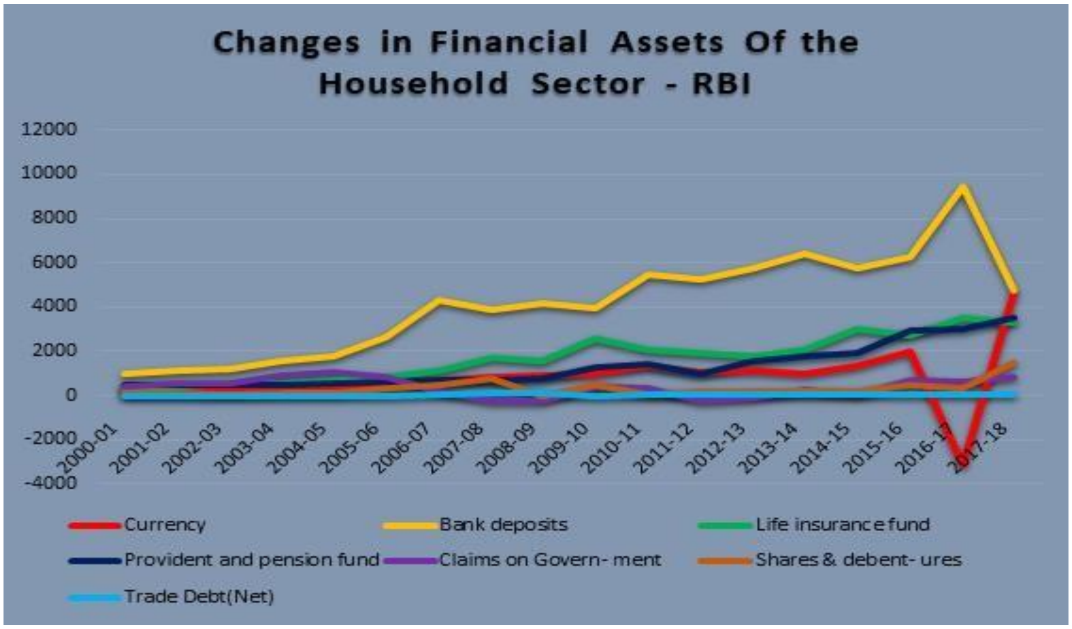

Figure 6

Conclusion

We can clearly see that the lack of knowledge in finance in the emerging economies as they are only investing in saving schemes and not in investment instruments. The gap in calculating compound interest between the developed economies and emerging economies is huge. The governments of emerging economies need to find different methods to educate people about the various investment options and finance in general.

References

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