ST.GALLEN SYMPOSIUM

Global Essay Competition 2023

Title: The road to equity: Moving from the legacy of financial illiteracy to owning financial well-being.

Essay:

"The test of our progress is not whether we add more to the abundance of those who have much, it is whether we provide enough for those who have little." ~ Franklin D. Roosevelt.

Introduction

On 16th January 2023, headlines highlighting the level of inequality in India were present in most newspapers, Oxfam had released a report on the first day of the world economic forum in Davos. It read that the richest 1% in India hold over 40% of the wealth and the bottom half together share only 3%. (The Hindu,2023)

Wealth inequality is blatantly visible in everyday life, slums exist right in front of ever-rising skyscrapers of billionaires and while the haves buy yachts of ever-increasing lengths, the have-nots are still figuring out a way to get a square meal.

The pandemic and the war with Ukraine have not helped the cause as wealth inequality has only grown. With the richest 10% percentage in the world holding 76% of the wealth, the inequality is close to those seen in the early 20th century at the heights of imperialism. Rising inflation has not eased the concerns either as the general masses are feeling the pinch of the quality of living decreasing. (World inequality report,2022)

History has time and again shown that inequalities have exacerbated the uprisings and led to a decrease in social cohesion.

In this essay, I ponder on the difference between income inequality and wealth inequality, and how they differ. Explore the recent technological transformation in financial areas and whether it could address inequity. I then explain with special focus to India, why financial access is not just enough, the need for financial literacy, and explore how moving from the legacy of recommendation-based investments which has defined our previous generations to research-based investments could help in solving the bigger problem of wealth inequality that we have inherited.

Does income always translate to wealth?

Generating income and managing wealth are two different skills. Although the global top 10% capture 52% of total income, they own 76% of the overall household wealth. Similarly, the middle 40% capture 39.5% of the income, they own 22% of global wealth, and lastly the bottom 10% capture 8.5% of the income and only own 2% of the wealth. (World inequality report, 2022)

While the level of inequality is visible here, another important aspect to notice is the gap between the percentage of income captured and the wealth owned by the different segments. It could happen due to two reasons, historical inequality in income generation or income not translating to wealth.

It's a case of the latter as historically averaging the incomes for the last two centuries generated by the different classes yields the current income levels. This implies that income generated does not always translate into sustained wealth.

I have seen households with modest incomes in the hinterlands of India using it for daily expenses and repayment of informal loans, thus having very little at the end of the day as savings. The problem arises due to them having to resort to 'loan sharks' for major expenses, the repayment of which depletes their income.

In developing countries such as India, financial access has been improving due to financial services such as banks & microfinance institutes being available to lower-income households. The 'Jan Dhan Yojana' aimed at providing a bank account for every household generated a record 443 million accounts, this alone is not enough as the usability of the services decreased over time. Access is only part of the equation as design, trust, and awareness of usage play an important role in reducing the socio-economic division that we have inherited. (Asian development bank,2022)

Pandemic - The catalyst for financial inclusion

The pandemic slowed down a lot of advancement around inequity, but it was a catalyst for financial inclusion that led to a sharp rise in digital payments amid the global development of formal financial services. It also led to people re-considering their financial habits and the ensuing easy monetary policy & lower returns on traditional investments meant that people experimented with newer asset classes.

Financial inclusion is crucial as people could benefit from various financial services including saving, making payments, and using credit when they have a financial account. Globally 76% of the population has now access to financial instruments, in India, the acceleration was even more pronounced as 78% had access and 80 million adults made their first digital merchant payment during the pandemic. (World bank,2022).

The effect of digitalization

Growing digitalization is leading to higher penetration of different methodologies of trading & investment. In India, wherein the digital financial revolution has been humongous, the number of people trading stocks jumped 2.2X, resulting in more than 70% of the traders being first-time investors (Business standard,2022). Similarly, the cryptocurrency market saw high adoption, with a world leading 115 million people trading in crypto assets & almost 40% of them being under 30. (India Today,2022)

The current personalized news and media feeding financial content recommending and reaffirming the decisions of people, it becomes necessary to ensure that people are informed and manage their risks appropriately.

The digital transformation while providing greater access, underscores the importance of building trust through educating and providing the right information to manage wealth.

Why is financial access not enough?

According to a recent survey done by the world economic forum, 40% of those who have financial access and don't make use of it, do so because they don't know how. Furthermore, 70% of them would be more likely to invest or invest more for long-term wealth creation if they had better financial education. It also mentions that many of the surveyed learned about managing money and investing many years after entering the workforce due to fear of losing money and the knowledge gap, thus negating the power of compounding. (World Economic Forum,2022)

The existing legacy for managing income has been to go ahead with a recommendation-based investment system and the current gen Zs and millennials have also followed a similar strategy, going by the words of advisors and, most recently ‘finfluencers’. These Financial influencers have enormous reach, in India people have flocked to them in droves, with the most popular ones commanding a following running into millions. The popularity is explained by the low financial literacy, with only 27% of Indian adults meeting the minimum level of financial literacy as defined by the Reserve Bank of India, one of the lowest even among emerging economies. (Asian development bank,2022)

Traditionally, in India, generational wealth has played a vital role in the decision to invest early and the quality of investments but with access improving thanks to demonetization and the ensuing focus on the digital transaction, empowering the people through financial literacy is the key to discontinuing the wheel of inequity.

Financial illiteracy – A cross-generational problem

The current problematic legacy of a recommendation-based investment has been passed across generations. Taking a personal example, I remember conversations wherein my grandfather bought stocks that were being manipulated in the 80s leading to the erosion of wealth slightly after, I have watched my father buy life insurances schemes on the recommendation of the agent which now looking back did not make much sense for our family, despite pursuing a postgraduate degree myself, I have recently been gathering knowledge about personal finance.

The transfer of financial risk from governments to individuals has expanded in scope. This means that the current generation would need to bear more responsibility and invest diversely for their long-term financial well-being. With the retirement age dropping fast due to technological progress and life expectancy increasing due to medical progress, accumulating sufficient assets to ensure retirement income becomes necessary. When the life expectancy becomes 80 and the retirement age 50, how do we fund the 30 years without much government support is an important question today's youth need to ponder. (Nithin Kamath, 2022)

In India, the absence of a country-wide social security system, the breakdown of traditional family support systems & fiscal stress of defined pensions for govt employees have led to the introduction of the National pension policy for all, wherein the onus lies on the individual to make the contribution & plan their well-being, unlike the previous generations.

Financial management as part of curriculum

Youth are mostly ignored from financial literacy programs as they are not part of the active investor community but investing in their financial literacy would lead to rich dividends.

Financial education needs to be experiential in nature and included throughout the school journey. While finance is slowly making inroads in the curriculum of many countries, there is a need for greater focus in this area. The report on 'Evaluation of National Strategies for Financial Literacy' has called for operationalizing the overall goal of improving the financial literacy of the population by segmenting the population and having specific target groups, for instance, youth in schools and colleges. (OECD,2022)

A case in point is an initiative in the US to help build the financial capability of young people by bringing banks to schools. 21 banks participated in the pilot, over 4500 youth savings accounts were created, and thousands more were educated. Students from kindergarten to sixth grade took part in the activities and higher-grade students acted as bank staff, resulting in internalizing the concept of savings. Interestingly banks found value in combining in-school banking with financial education as it helped build a savings mindset and gave access to students. (FDIC,2017).

Such an initiatives when introduced in developing countries such as India, the twin objectives of financial access and literacy can be met

Designing platforms for long-term wealth creation

There is a need for financial institutions to remove friction through product, tech interventions and nudging the users to make the right decisions. Platforms should reward customers for good financial behaviour instead of just penalizing mismanagement.

A score-based system that measures the creditworthiness of the individual is available. Similarly, a score to measure financial literacy could be built and the fintech could then gamify the experience to nudge the users to improve their score. With mobile/card-based payment systems increasing exponentially in recent years, money has become less tangible, and hence the spending occurs unnoticed. To counter this, automatic budgeting systems by banks could aid in better management.

Mandating the start-ups in the fintech space to maximize the value for customers in the long term could help. Unicorn start-ups in India in the fintech sector such as Cred and Zerodha have shown that this can be done. Cred has been built with the premise that better credit management is necessary in a country such as India wherein 95% of users of credit cards are first-time users.

Zerodha, a trading platform has always set its goal as equipping traders to trade well and has restricted itself from being a recommendation service. It has a platform to increase financial awareness and recently introduced its junior version to help create financial awareness in the younger generation, so that they are better prepared for life. (Nithin Kamath, 2022)

The road to implementation

While many countries have come up with the policy changes, a lack of implementation has plagued them, and adequate resources are needed to make it a continuous and sustainable proposition. Here are three ways through which it could be implemented.

I. Usage of unclaimed wealth
   - Unclaimed wealth lying dormant in stock exchanges, banks & insurance companies belonging to the bygone generations could be used to support financial literacy for the coming generations.

II. Mandating the fintech to acquire customers post making them literate.
   - Putting in place a regulatory framework to ensure customer acquisition is done post-customer training, especially in riskier assets.

III. The current investing community to fund the literacy of the coming generations.
   - A part of the taxes gained through trading of real estate, jewellery, or equities to be set aside for financial inclusion and literacy.

Conclusion

In Hindu mythology, Lakshmi, the goddess of wealth, sits on a lotus. Saraswati, the goddess of knowledge, sits on a rock. This symbolizes that money floats like a lotus and knowledge, like a rock, once gained stays forever.

With wealth inequality rising, the inter-generational problem of financial illiteracy needs to be addressed. Digital solutions and financial inclusion glimmer as a light of hope to ensure people manage their income better and gain confidence in exploring newer forms of financial instruments, thus helping them convert income to sustained wealth and this is bound to have a domino effect across generations to address the SDG of reduced inequalities.

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