Financial discipline for a better life

India is growing, and growing very well. If India continues its growth story for 20 years, 291 million people will come out of poverty and start leading a better life. As this remarkable phenomenon unfolds, formal banking will become the key to making them lead better lives. These people will have entered the banking system for the first time, and they are likely to be touching and feeling banking without much knowledge about this world. It is in this context that financial education becomes an imperative today rather than later.

Leave aside first-time banking customers... even in the educated socio-economic strata, financial literacy is low. The other day a chartered accountant was defaulting on his personal loans repayment. On probing we found that he had a fixed deposit of Rs. 1 lac earning him 8% p.a. while simultaneously he was running a personal loan and paying an interest of 18% p.a. We find cases where customers revolve credit on their credit card at 38% p.a. for months at a stretch, while at the same time running balances in their savings account or having assets which they could have mortgaged and availed of better rates. And this is among the educated lot; such is the level of financial literacy. There are others who understand all this too well, but are just too short of time to manage their monies – these are the "money-rich, time-poor" sorts.

Apart from borrowing and saving, customers have needs for investment and protection. People often put off investment decisions for too long. When they realize they may have lost valuable time, they try to make it all up by "get-rich-quick" options. Barring exceptions that could go either way; in the long run there is no such thing as "get rich quick ". Investments have to start early, have to be planned over time taking into account the age and profile. Steven Covey in his book "The 7 Habits of Highly Effective People" mentions how the "urgent" in our life too often gets priority over the "important". Insurance often suffers from this precise phenomenon.

Lack of financial literacy is the root – the symptoms will appear in the form of debt traps, unsatisfied investors and underinsured customers. It is not the ones who earn more who will lead better lives, but the ones who manage their money better.

In a series of 52 editions, we will bring to you advice and tips to manage your financial lives better. We tried doing an advertisement campaign-advising customers not to revolve credit on their credit cards for more than two months. The campaign gave tips on how to plan repayment cash flows before signing on the dotted line for a loan. But these ads, we realize, have a limited shelf life and we were unable to cause a lasting impact on customers. We conducted a survey and found that few followed the campaign, let alone remembering the points. We hope that the "Customer First" series that we are launching now will have a much larger impact as this will be sustained over a longer duration.

The articles will cover opinions of experts and independent bodies and make it relevant to current and prospective customers. Hopefully, this will help customers lead more financially disciplined and better lives. We will be grateful for your feedback.

V. Vaidyanathan
Executive Director, ICICI Bank

DID YOU KNOW?
Whether it's the frequency of replacing cellphones, taking vacations or shopping, the standard of lifestyle you set has a tendency to become the base for you. It becomes tough to come down the ladder because a lifestyle is a habit.

BUYING A HOME? MAKE A 'REALTY' CHECK FIRST!

Buying a house may seem like a daunting task, especially since it is as much an emotional decision as a financial one. Here are few pointers to understanding the financial implications better.

Vishwajit Balakrishnan* (aged 54) is due for retirement in a couple of years. All his life, he and his family have lived in the company's quarters. There were so many commitments to take care of — his sister's wedding, son's education, and healthcare of his parents — that Vishwajit could not buy the dream house he and his wife longed for.

Varun, the 27-year old software professional son of Vishwajit, decided to surprise his parents on their 30th wedding anniversary. He handed them the key to their new flat. When a moist-eyed Vishwajit asked how Varun managed something that he could not in all his earning life, Varun simply told him that he had taken a home loan. Loan was a term that unnerved Vishwajit. Varun went on to explain to his father, how carefully considered this decision was. Here are some key principles which will help you to make a sound home-purchase decision.

Invest young
Any time is a good time to buy a home; but the benefits of investing in one when you are younger are numerous. Believe it or not, if you are 25-30 and in your first job, you can buy a house and have it repaid by the time you are 40. Be debt-free from then on.

When you are younger, the repayment tenure offered by banks is longer as you have age on your side. You can always make sure that the loan is paid up as your career and income rise. Also, you can swap to a larger property as your career progresses.

It is advisable to buy a home early on in life when one's financial commitments are controllable. For youngsters in their first job, it is an impressionable time. It creates a forced saving and the investment also gets time to appreciate. What's more, you can save tax under section 80C.

How much can you afford?
Check your "assured" cash flows – don't be overly optimistic and don't borrow on optimism. Provide sufficiently for your monthly expenses. Keep some margin for unexpected bills. Leave some aside for interest-rate fluctuations and emergencies. A good thumb rule is to keep at least 50-60% of your income for all these expenses, and repay EMIs from the balance.

Trim your lifestyle to meet your commitments
Set your lifestyle to suit your net income after providing for the home loan repayment. Whether it's the frequency of replacing cellphones, taking vacations or shopping, every level of lifestyle has a tendency to become the base for you. It is tough to come down the ladder, because lifestyle is a habit. Borrowing on a credit card to tide over an emergency is fine, but to revolve continuously at high rates is not. Never borrow more to repay existing loans. This habit starts innocuously but leads to a debt trap.

Compare and suit yourself
Compare rates, fees, and down payments among different lenders. Try putting down as much down payment as possible and reduce the loan amount. The good news is that most organizations now quote on a monthly reducing basis; i.e. your principal repayment is adjusted every month to your loan outstanding.

Take into account the closing costs
Provide for the closing costs on the property transaction. These are significant, at about 20% of the property value, and include costs incurred on brokerage, registration, stamp duty, property taxes, and charges for various amenities. Most lenders charge a fee for pre-payment of the loan. Read the terms and conditions of the loan agreement carefully before signing.

Once you have done your homework systematically, you are ready to put a smile on your families' face.

Pooja Punjabi
*Names changed

SUMMARY
- Check your cash flows. Be sure and not overly optimistic.
- Check your lifestyle to suit your commitments.
- Property prices can go up or down. The US mortgage experience tells us that. Good to buy property as a utility and better not to speculate.
- One strict no-no: Never borrow more to repay existing loans. This habit starts innocuously but leads to a debt trap.
- Shop around for the best possible rate along with favourable terms of repayment.

Kindly send us your suggestions and comments by visiting the "Email Us" link at www.icicibank.com