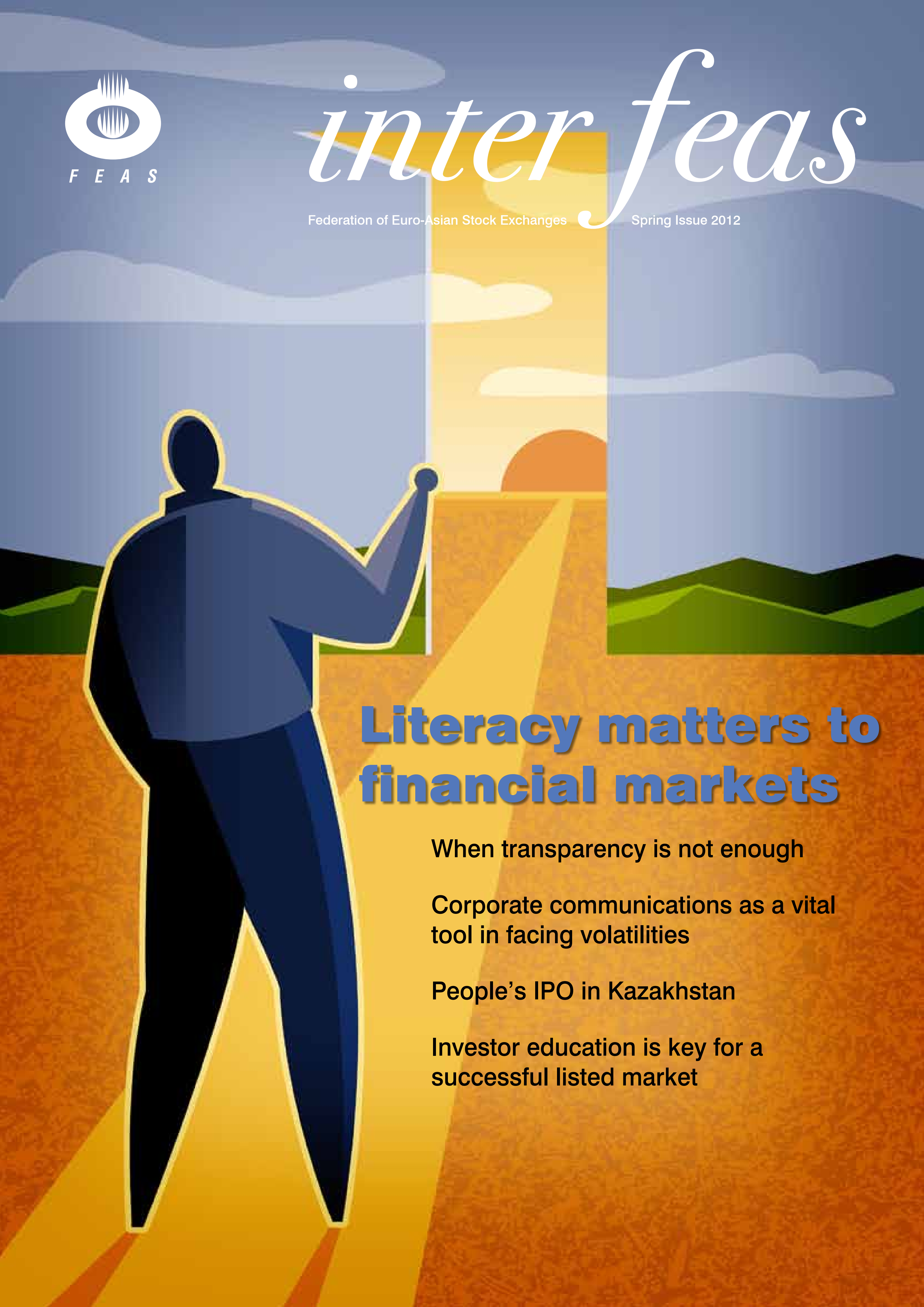

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## Literacy matters to financial markets

When transparency is not enough

Corporate communications as a vital tool in facing volatilities

People’s IPO in Kazakhstan

Investor education is key for a successful listed market

# When Transparency is Not Enough

## The Surprisingly Important Role of Financial Literacy in Well Functioning Capital Markets

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Transparency in a nation's capital markets has long been considered a prerequisite to a successful stock exchange and to the free flow of capital within and beyond a nation's borders. As individual investors increase participation in capital markets, however, mere transparency is not enough. For transparency is of little value if investors do not understand what they see. Financially unsophisticated investors have the potential to jeopardize not just their own futures, but the futures of their nations' markets and economies through the uninformed choices they might make. To prevent this outcome, national governments, exchanges and listing companies all have an important, but largely unrecognized need to help their population become financially literate.

But why should they care? With capital markets in many countries largely driven by institutional players, many from foreign countries, why does the financial literacy of the individual domestic investor even matter? The reasons are multiple and compelling. By cultivating a nation of financially literate citizens, a country can grow its domestic base of investors, enhance its ability to weather market shocks, complement its regulatory efforts and strengthen the reputation of participating organizations.

### Growing a National Investor Class

Anecdotal evidence and ample experience suggest that, with a few notable exceptions, many post-crash consumers fear the unknown and are unlikely to participate in investments they do not understand. Even the availability of professional advisors may not remedy this. As our firm found in its 2010 study of the market for financial advice in the US, middle income investors who are in need of financial guidance sometimes avoid advisors because they may not trust advisors' objectivity and are uncomfortable with the asymmetry of information between themselves and the advisors.[1] In other words, unless consumers have a basic knowledge of investments they may not have the confidence to work with an advisor.

The unavoidable conclusion to be drawn from this is that education is necessary to transform an individual with assets into an investor and, potentially, a consumer of advisory services. The collective result of such efforts could be a significant increase in the proportion of households having a direct stake in the success of the nation and its businesses. Such local buy-in also sends a powerful message to foreign investors that the people who know the country best are optimistic and willing to personally commit to their nation's future.

### Reducing Market Volatility

Imagine two individual investors. One wishes to invest because he believes the unrealistic promises someone made to him about the riches one could quickly accrue investing in an emerging market. The other has been equipped with the financial knowledge to understand both the benefits and risks of investing and to examine the underlying fundamentals about the listing company and the country hosting the exchange. Both individuals decide to invest in the same instrument. Then a market shock occurs and the value of the instrument falls significantly. The unknowledgeable investor immediately dumps his investment, which both locks in his individual losses and contributes to a growing contagion. By contrast, the financially educated investor analyzes the market turmoil and rationally decides what it might mean for her investment strategy. She may make adjustments to her portfolio, which might even include buying into market weakness, so that she is well-positioned to profit from a rebound.

The difference between these two investors is financial literacy. One benefitted from its presence, the other suffered from its absence. Now imagine this scenario playing out on a scale of hundreds of thousands or, perhaps, millions of individual investors. Is it hard to believe that educated individual investors could actually have an effect on market volatility – putting in a market floor on the downside and constraining the tendency toward bubbles on the upside? Even sophisticated institutional investors should recognize that a smarter individual investor is better for everyone.

### Complementing Regulatory Efforts for Investor Protection

During my years at US Treasury two of my long-held beliefs were proven for me on numerous occasions: first, that strong consumer protection regulation is essential for a robust financial services marketplace and second, that such regulation has its limits. Regulators can ensure that financial products are designed fairly and disclosed accurately, but ultimately the choice of if and how to use such products rests with the consumer. For example, an investment can be appropriate for one person, but not for his or her neighbor. Providing financial education for both will permit each to make the correct decision for his or her situation.

Moreover regulators are mistaken if they believe this issue can be addressed with disclosures alone. While adequate disclosures are necessary, it is equally true that the unread disclosure discloses nothing. Investors must be taught how to make intelligent use of disclosures, how to distinguish between investments and their particular risks and how to seek regulatory remedies should their rights be violated.

So long as there are free markets there will be investor choice, and, with it, the opportunity to make a uniformed and detrimental choice. Therefore one of the best forms of investor protection is investor education. Market regulators that recognize this will see financial education as one of several important tools at their disposal to protect investors' assets and preserve overall market confidence.

## Enhancing Corporate Reputations

Just as companies that prey on investors' ignorance are viewed as disreputable, the reverse is also true. Those few companies that actually seek to educate potential investors can distinguish themselves as some of the most highly respected brands in the financial services marketplace. However it is important to note that the term "educate" as used here is not another word for "sell." If a company can provide truly objective investor education before and outside of the selling context, then that company will not only earn investor trust, but investor business. While it is true an investor, once educated, might take his or her new knowledge and invest elsewhere, research suggests a strong link between trust and sales success.[2] It is almost as if investors are saying, "if you trust me with knowledge, I'll trust you with business."

As we tell our clients, financial literacy no longer means just simple brochures and websites assembled by an organization's communications staff.

## The Way Forward

All of the goals described above can be achieved through active implementation and ongoing support of financial literacy initiatives. However financial education should not be mistaken for a panacea. Continued research is needed to better understand how financial education efforts affect investors, and nations must simultaneously pursue a number of other important priorities to develop thriving capital markets. Specifically emerging markets must continue to invest in their technological, regulatory, financial and management infrastructures. However the important point to take away here is that the work of financially educating investors and potential investors belongs on that critical list of tasks to achieve. That is likely why FEAS listed increasing financial literacy as one of its nine strategic objectives.

As we tell our clients, financial literacy no longer means just simple brochures and websites assembled by an organization's communications staff. Instead contemporary financial literacy is beginning to encompass a whole array of sophisticated educational interventions, informed by the latest research, strategically targeted, precisely executed and rigorously measured for outcomes, all with the objectives of engaging consumers, increasing knowledge and changing behavior.

As described above, stock exchanges, regulators and companies in emerging markets are well-positioned to tap the still unrealized potential of financial literacy as they all seek to brighten the futures of their investors, their capital markets and their national economies.

1. Dan Iannicola & Jonas Parker, Financial Literacy Group (2010), Barriers to Financial Advice for Non-Affluent Consumers, Society of Actuaries
2. Deepak Sirdeshmukh, Jagdip Singh, & Barry Sabol, Customer Trust, Value and Loyalty in Relational Exchanges, Journal of Marketing, vol. 66, (Jan 2002) 15-37. John E. Swan & Johannah Jones Nolan, Gaining Customer Trust: A Conceptual Guide for the Salesperson, Journal of Personal Selling & Sales Management, Vol. 5, No. 2 (November 1985), 39-48.

**About Dan Iannicola, Jr.**

Mr. Iannicola is an international leader in the financial literacy movement and since 2009 has headed The Financial Literacy Group (FinancialLiteracyGroup.com), a consulting firm which helps organizations design, produce and deliver research-based financial education programs, strategies, curricula, campaigns and program evaluations. From 2003-2009 he was the US government's top financial literacy official, serving as US Treasury's Deputy Assistant Secretary for Financial Education. In this role he coordinated 20 federal agencies to draft and execute the first US national strategy for financial education, commissioned the country's first national survey of adult financial capability and launched a number of national financial education programs for youth and adults. Additionally he was the first Executive Director of the President's Advisory Council on Financial Literacy. Prior to his government service, he practiced credit and banking law for eight years in the private sector. He is a graduate of the Wharton School of Business, the University of Illinois College of Law, and the American University Graduate School of Communication.