HOW GOOD IS BEING AVERAGE?

Can you spot the symptoms of impending financial ill health? Promiseland's managing director Mr David Choo tells you about the three groups to look out for.

Coming a close second to the most dreaded word "FAIL" in a school report card is the word "Average". Being "average" simply is not good enough for the teacher and for parents who know its meaning. Being an "average" student is often an euphemism for being slow. Today, the less offensive term preferred by educators is "under-achiever".

But far from dropping out of use, the word "average" is probably one of the words that really pays to understand what it really means. I will focus on its use in statistics in general and its application to the financial services industry.

Firstly, it is important to note that the word "average" can be used loosely to mean somewhere in the middle. Those familiar with statistics know that there is an important difference between mean, median and mode, which are all measurements of average.

"Mean" is perhaps the most easily understood of the three terms. If you have 39 students with different scores in mathematics, add up all the 39 scores and divide by 39, and you get the mean.

If you line up all the scores from lowest to highest, the 20th score is the median, and it can be quite different from the mean. The median score is such that there is equal number of scores above and equal number of scores below the median score.

If you analyse all the scores and, say, ten scores are 55 and the other scores are well spread out, you can say the modal score is 55. Again, it can be quite different from the mean and the median.

You will notice that the median and the mode in this simple example are actual scores. The mean score may actually be a score

PHOTO WWW.123RF.COM

that none of the students have scored. In this sense, some people say the mean as a statistical concept can be described as a mythical concept. It is good to use it as a benchmark, but take care because it may lead to making wrong decisions as the following examples demonstrate.

AVERAGE HOUSEHOLD INCOME

The Straits Times carried an article entitled "Mind the Income Gap" on Saturday, July 8, 2006. The top heading read "The average household income here has risen, according to a new survey. But at the same time, the income gap has widened. Incomes of families in the bottom 20 per cent are shrinking while the top 20 per cent are making more."

Further, it stated that from 1990 to 1999, incomes of families in the bottom 10 per cent fell from $370 to $133, a decline of 78 per cent. Also, from 1990 to 1999, the income of the top 10 per cent soared from $9,669 to $15,451, a rise of about 60 per cent.

More recently, the latest household survey from 2000 to 2005 showed the income of the top 10 per cent of families increased by 14.7 per cent. However, families in the 11th to 20th percentile saw their income drop by 4.3 per cent a year in the past five years. The bottom 10 per cent has no work income. But the "strange" thing is that the average household income rose by 5.4 per cent in 2005.

> **"WHEN ASSESSING WHETHER YOUR INSURANCE PROTECTION IS ADEQUATE, DO NOT BE INFLUENCED BY THE AVERAGE STATISTICS."**

My interest here is not to analyse the reasons for the widening income gap or why the top 20 per cent earn 12 times that of the bottom 20 per cent.

My interest is to state that the figure of the average household income is a statistical and mythical figure. If there was income equality, the "average" Singaporean family would be enjoying life much better as the figure is about $3,000 per month. How many per cent of Singaporean families actually earn this?

More specifically, ask "What is the income that requires insurance protection for each person?", rather than use the average income as a benchmark. This may explain why the insurance protection is considered inadequate in Singapore.

AVERAGE DEATH CLAIM

The average death claim paid by the life insurers in the first six months of 2006 was $30,000. The figure was $38,000 for 2005. How do you interpret this figure?

Comparing $30,000 with the average household income of about $43,000 per annum, one can say that, on the average, the Singaporean is insured for less than one year's annual wages.

Of the total policies in the insurance books, the average sum insured is about $39,000.

It would be interesting if there is a study of insurance protection against household income because, my observation is that, the people who buy insurance are generally the more well-to-do, although not the ultra rich, who in a way, are self-insured. The majority of the lower income have very little insurance.

When assessing whether your insurance protection is adequate, do not be influenced by the average statistics. Compute what you need based on income replacement, debt repayments, final expenses, etc. ascertained through a financial needs analysis or financial planning process.

What about medical needs?

AVERAGE MEDICAL COST

In another Straits Times article on August 25, 2006, the statistics of health cost were examined.

The bill sizes for patients in public hospitals in 2005 had just been presented showing an average bill of $3,473 for Class A, $2,736 for Class B1, $1,094 for Class B2 and $858 for Class C.

These average bill sizes did not raise alarm bells, especially since the average Medisave had $13,000.

The 95th percentile figures were much higher being $10,769, $8,576, $3,524 and $2,747 respectively.

But the question was rightly asked: "How high were the top five per cent of bills?"

For medical expenses, people should be concerned for the worst case scenarios, not the average bill size.

What about life span figures?

AVERAGE MORTALITY AGE

Statistics show males live up to 83 on average and females up to 86. How do we interpret these average figures?

Taking the example of males, what the figure of 83 means is that there are going to be as many males dying younger than 83 as there are dying at or older than 83. When the mortality for male was about 70 in the 1980s, many Singaporeans already had parents living up to their 80s and 90s. With average mortality of 83, we should expect half to live beyond 83 and a good number to live to their 90s, and possibly passing the century mark.

The implication is that all of us should prepare for a long life and ensure that there is enough for savings for retirement and adequate medical insurance for life. Life annuities, which are insurance products paying a sum of money for as long as the person is living, should be considered even if the returns are not as attractive compared to that of earlier years. The current return of two per cent to three per cent is unexciting, but, considering the mortality statistics, at least you can ensure you would not outlive your income.

The word "average" as used in general insurance has a totally different meaning, which I will not cover here.

I hope by now you can see that it pays to delve further into "average" figures. For every subject, there is always something more important than the average figure. Where clothes are concerned, some average built people may be able to buy their clothes off the rack, but where financial needs are concerned, it is best to have them custom-tailored. **SI**

David Choo, ChFC, CFP, is the Managing Director of PromiseLand Independent Pte Ltd, a licensed Financial Adviser. He can be contacted at email:davidchoo@promiseland.com.sg or telephone no. 62942461.