Should You Save or Borrow to Finance a Big Purchase? Here's How to Decide

- Your dream home, luxury cars, overseas vacations require high capital
- Planned expenses are often met by liquidating investments
- If the cost of borrowing is lower than the expected return from investments - is borrowing better?

Scenario Analysis

Do you have time before you need to make this large purchase?

YES

SAVE AND BUILD SUFFICIENT CORPUS.

- Budget the required investment through your monthly savings by incorporating inflation
- Remember to be realistic while assuming returns on your investment!

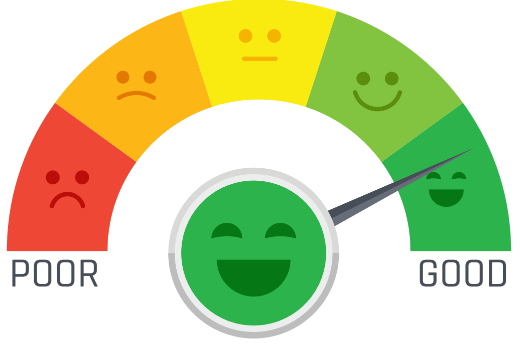
NO

YOU DON'T HAVE AN OPTION BUT TO BORROW.

- Compare & borrow on competitive terms
- Use an online EMI calculator to ascertain the tentative EMI, ensure it is affordable.

Spoiler Alert:
To borrow on "Competitive Terms", you need to have a "GOOD" Credit Score.
A credit score > 700 is considered "GOOD" and creditworthy of a loan[1].

So, do you have a good credit score?

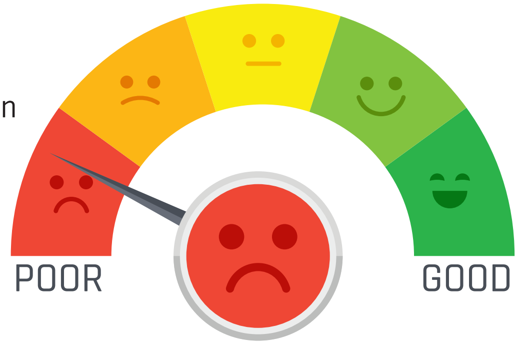


Yes! (Credit Score>=700):
You can borrow on competitive terms

Is your Interest Rate < Expected Return on Investments?
- Yes: Consider borrowing
- No:
  - Look for more competitive rates to borrow OR
  - Consider liquidating your investments instead of borrowing!

Note: The credit score is an important criterion to ascertain the interest rate on your borrowing. Paying your outstanding bills on time, remitting your existing EMIs as per schedule, clearing your credit card dues before time and in full can be key to ensuring a higher credit score

No! (Credit Score< 700):
You have limited options
- Try to postpone your purchase to a later date such that you can either:
  - Save up for the purchase by that time OR
  - Improve your credit score to avail of a competent loan
- Availing of a loan with a bad credit score is synonymous with paying huge interest rates



Pros and Cons Time:

Pros of Saving:

a. **No EMI = No financial stress:**
There is no interest component on investment that you will have to pay out. Knowing that the money is yielding returns minimises stress.

b. **Increases financial prudence and investment discipline:**
Accumulating debt for lifestyle purchases may not be prudent and may lead to a debt trap. Saving inculcates a disciplined way to handle finances.
Invest to make money work for you. This can increase financial prudence and discipline.

c. **Superior purchase experience:**
Knowing there is no financial obligation post the purchase will enhance your buying experience and lend peace of mind.

Cons of Saving:

a. **Limited budget:**
Affordability is restricted by the corpus built.

b. **Time-consuming:**
Liquidating investments can take time, collating funds from various investment avenues could be cumbersome.

c. **Hindrance to other milestones:**
Unless you have specifically ear-marked investments for this particular spend, the liquidation could potentially hinder other financial goals.

Pros of Borrowing:

a. **Tax breaks:**
Some "good" loans such as home and education loans provide tax benefits that could reduce the tax burden.

b. **No restriction on a budget:**
Loan quantum can be as much as the purchase cost, subject to EMI affordability.

C. **Multi-purpose loans:**
Personal loans can be used for a variety of purposes, afford greater flexibility in spending.

Cons of Borrowing:

a. **EMI burden:**
Debt often creates financial stress and is a restrictive commitment.

b. **Other charges/penalties:**
Apart from interest, there are other charges. Late payment or non-payment may lead to a penalty.

c. **Impact on credit score:**
Borrowing has an impact on credit score and will determine your eligibility to borrow in future.

So, if you have time at hand, save up for your expenses. Else take a loan but only at competitive rates which are within your means!

Sources:
1. https://www.bankbazaar.com/car-loan.html
2. https://www.bankbazaar.com/home-loan-interest-rate.html
3. https://www.bankbazaar.com/personal-loan-interest-rate.html