C | Compound Interest

Compound interest happens when your money earns interest, and then that interest also earns interest. It is one of the most powerful ideas in personal finance because it helps money grow faster year after year. First, your money earns returns, then those returns begin to earn returns too. That's when growth gathers momentum and your money begins to grow faster.

This is why those who build wealth start investing early. The longer your money stays invested, the more time compound interest has to work. Compound interest also helps your money grow faster than inflation.

Inflation is the gradual rise in the prices of goods and services over time. As prices rise, the same amount of money buys less. But when your money grows through compound interest, it can help protect and increase your buying power over the long term.

Example

How ₦100,000 Grows at 10% Annual Interest

Year	Opening Balance (₦)	Interest Rate	Interest Earned (₦)	Closing Balance (₦)	Explanation
1	100,000	10%	**10,000** (10% of 100,000)	110,000	You earn ₦10,000 in interest on your original ₦100,000.
2	110,000 *(from Year 1)*	10%	**11,000** (10% of 110,000)	121,000	Interest is calculated on the new total of ₦110,000. You earn ₦11,000.
3	121,000 *(from Year 2)*	10%	**12,100** (10% of 121,000)	133,100	Interest is calculated on the new total of ₦121,000. You earn ₦12,100.

Key Point: Each year, you earn interest on your new total balance, not just on your original amount. This is how compound interest helps your money grow faster over time.

If you invest ₦100,000 at an annual interest rate of 10%, your investment grows to ₦110,000 after the first year. That is because you earned ₦10,000 in interest on your original amount.

In the second year, interest is no longer calculated only on the original ₦100,000. It is calculated on the new total of ₦110,000. At 10%, that gives you ₦11,000 in interest, bringing your total to ₦121,000.

By the third year, interest is earned on ₦121,000, adding ₦12,100 and bringing your total to ₦133,100.

This pattern continues year after year. Each time, interest is calculated on a growing balance, not just the original amount. That is the power of compound interest.

Common Mistake

You can make the mistake of delaying investing because you think you need a lot of money before starting. But …….

…You've just read a preview of **the chapter, Compound Interest.**

The complete chapter, together with 25 more practical money lessons, is available in *The A to Z of Money*.

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