Financial Planning & Managing Personal Finance

Financial Planning is a Goal based planning in order to accomplish various goals namely buying a dream house/Car, Overseas Vacations, Children Education/Marriage and Retirement Planning. One goes on to say "**Proper Planning Prevents Poor Performance**." Three stages to be considered in Financial Planning comprise of Wealth Creation, Wealth Preservation/Accumulation and Wealth Distribution.

Financial Planning process involves understanding requirements, preparing a tentative-cum-final plan for execution followed by periodical reviews and re-balancing. Financial Planning concept includes building an Investment as well as Insurance Portfolio, linked to Income and Savings. Asset allocation to be done based on the risk profile along with Tax Planning and Estate Planning.

Normally, income is derived from active sources as well as passive sources. Combining these two one has to allocate expenses in a certain proportion with emphasis on savings. While preparing Financial Plan, existing assets as well as liabilities to be considered for fund allocation to various goals. There are flawed notions that Financial Planning is only for rich, which is not so, even one with surplus/savings of Rs 500/- per month could start Financial Planning to achieve various goals.

These funds should be kept in the form of Cash or Cash Equivalents, so as to redeem them as soon as possible. The contingency could be medical reasons, loss of job, economic slowdown in business and unforeseen circumstances. The Cash Equivalents could be defined as Savings deposit, Liquid Funds, Short Term Fixed Deposits and 2-in-1 Bank accounts.

Usually, Investors aim to build an **Investment portfolio** only whereas **Insurance Portfolio** is equally important as Investment. Investments could be in Real Estate, Direct Equity (Shares), Equity-linked instruments (Equity & Balanced MF Schemes), Bonds (Tax-free & Taxable), Debentures , Debt MF Schemes, Government Small Savings Schemes, Fixed Deposits, Bullion/Metal, Currency, Commodities, Art & Artefacts and Alternate Investment Funds.

Insurance Portfolio should aim to cover protection in the form of Term Insurance equivalent to at least 10 times of annual income. The purpose is to make provision for regular income to the dependent family, in case of demise of the earning member. The endeavour should be to get the protection immediately after commencement of employment/business. This will ensure the adequate coverage at low premium that gets blocked for a longer duration to cover the risk, depending upon annual income. Second aspect is to cover oneself with personal accident insurance cover for which a nominal premium may be required or it could be obtained as rider with Term Insurance Cover.

Personal Accident Insurance cover takes care of permanent disability coverage even when one is alive.

Health Insurance (family floater) for self and family is required to cover hospitalization expenses. In case employed with Government/PSU/Corporate, health coverage is provided by the employer but additional coverage is advisable depending on cost of hospitalization or non-availability of health insurance cover post-retirement. Critical-illness is an expensive proposition for which an exclusive policy may be obtained or a top up insurance cover could be taken along with health insurance cover. While Health Insurance benefit is available, generally, upon hospitalisation. Critical illness coverage results in lump sum payment upon identification of illness.

Post coverage of Insurance Portfolio, one has to understand Risk Profiling part of the Investors, based on the certain questions derived out of individual/entity behaviour to ups and down (volatility) of the prices. This risk profiling would be more related to Stock Markets performance although it applies to all asset classes. Generally, risk is classified into four types namely, **Risk Averse, Conservative, Moderate and Aggressive**.

Risk Averse Investors prefer **guaranteed returns** on investments such as Fixed Deposits, Government Small Savings Schemes, Tax Free or Taxable Bonds with fixed Coupon rate, top rated debentures of Corporate. **Conservative** profile might look at Debt funds where returns are not guaranteed but appreciation happen in the falling interest rate regime and indexation benefit is available if investment horizon is beyond 3 years. The returns could be subdued in the rising interest rate era. **Moderate** risk taking investors believe in combination of Equity and Debt MFs where 65% gets invested in Equity and balance 35% goes into debt securities for tax efficient investors otherwise the proportion could vary. **Aggressive** investor is the one who is willing to invest in any type of asset class and always have a diversified portfolio with inclination towards Equity and Equity MFs. These type of investors have 5 years+ time horizon and believe in investing more funds when stock market falls. They are even willing to lose part of the capital for deriving maximum gains. There are two maxims which apply for **Risk Averse and Aggressive Investors** in the form of "**Lower risk lower gains" and "Higher risk higher gains"** respectively.

In order to **inculcate savings habit** among citizens, Government provides certain Tax Savings benefits, which is an avenue for Tax Planning by investors. These type of investments from citizens are also part of the Government long term borrowing program. In other words, investments by Citizens into Tax Saving instruments are a borrowing by the Government where it has to pay interest on the borrowed funds. These Savings are utilized by Government for funding various development plans and/or Citizen Welfare schemes.

Estate Planning is also an important aspect of Financial Planning where seamless transfer of Wealth after your demise to successor or legal heirs is ensured. Wealth means all asset one owns which include property, vehicles, jewellery etc. If there are any liabilities of the deceased those also get transferred. Nomination, formation of trust, Will (Registered or Un-registered) and Charity are various forms of transfer of wealth.

Last but the vital part of Financial Planning is monitoring investment at periodic interval and re-balancing to be carried out wherever required. The timings of the financial goals are dynamic in nature, which keep changing based on the circumstances. As ones income keep growing the living standard also goes up. The investments should also be commensurately enhanced gradually. Financial Market conditions depend upon the growth of the Economy, Conducive environment, liquidity, fresh inflows by FIIs and DIIs, Corporate Results and Global cues. Concluding Financial Planning by writing about flawed notions:

Financial Planning is for affluent; **Insurance** cover is Financial Planning; **Tax Planning** is Financial Planning; when to start Financial Planning; Ambiguity between Financial Planning and Investing, and last but not the least Liquidity versus Investments.

Managing Personal Finance

There are four types of economic activities for the individual consumers.

Earning
Spending
Savings/Investing
Borrowing

Earnings could be active earnings or passive earnings. Earning by way of Salary when employed; running a business/profession are active earnings. When one receives pension, annuity, rental, interest and dividend on Investments those are called as passive earnings. An individual's Career Choice, getting an employment and ability to grow in career/business/profession determine ones likely earnings and standard of living. Coming to the factors those could potentially affect earnings; Career chosen/type of job, Geography of employment, Education level, Employability skills, Prior Experience/Performance, Economic Environment, Workplace trends and opportunities, Competence to grow in career/profession/business.

Spending is money consumed for purchasing goods and services. The way one spends money determines the value received, and influences economy. Every purchase contributes to the demand for product or services. An economy can't produce all goods and services that consumer want, and majority doesn't have resources to get what they want, which is also called as Law of Scarcity.

Scarcity prevent choices among alternatives; When making a choice alternatives are sacrificed; Highest valued alternative is sacrificed when choice made is based on the Opportunity cost; Choosing one item above other is called Trade-off; Responsible Spending includes researching & planned purchases, and making wise choices in the light of opportunity costs and Trade-offs that apply.

Next economic activity is **Savings,** which means putting aside funds for use at a later date. The form of savings used determines the return on the investment. Keeping cash at home for one full year would mean depreciation in its value by equivalent inflation rate. Putting funds in Savings deposit of a Bank would give a return of 3.5% to 7%, depending upon the Bank/Entity where funds are parked. Making a Fixed Deposit or investing in Government Small Savings Schemes would give you a return from 6.5% to 8.3%. All the aforementioned investment returns are taxable except PPF, Tax Free Bonds and Sukanya Samruddhi Yojna, to name a few. There are other asset classes where funds could be invested depending upon risk appetite of the investor. Savings and Investments are two sides of a coin where investment means deploying funds judiciously.

Later usage of **Savings/Investing** could be Contingencies, Routine Expenses, Future Purchases, Financial Goals and Retirement Planning. Benefits arising out of Savings/Investment could be earning passive income, produce a robust economy, provide financial security, growth opportunities for business ventures, Responsible investing forms the habit of regular saving and finding avenues yielding higher returns. Equity MF schemes and Debt MF schemes provide market-linked returns on the investments.

Borrowing means procuring funds, goods and/or services today, with a promise to pay at a future date. Maxim applied is "Buy now and Pay later". Some of the examples of borrowing could be usage of credit cards, purchases on EMIs, Pay day loans, Cash Advances and availing retail loans. Reasons for borrowing could be major purchases, meet contingencies, convenience, planning for future goals and taking advantage of attractive discount Sales/Offers. Responsible borrowing means timely repayment of loans as and when due.

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