Concentrate on Personal Financial Management – It's High Time

In the era of globalization, Indian economy is facing continuous reduction of interest rates. Therefore, conventional savings in bank fixed deposits and Government Securities are no more an effective parking slots for the Indians' hard earned money. Simultaneous, reforms in financial sectors have opened a number of alternative channels for savings. At the same time demand and supply pattern of personal finance has also changed in conjunction with the change in lifestyle and social system. Therefore, the time has come to think about our personal Financial Life Cycle Planning seriously to avoid any kind of catastrophic circumstances in our and our dependents' life.

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Financial Life Cycle Planning is the heart of personal financial management. Therefore, prior to having discussions on personal financial management we should understand the Personal Life Cycle Planning.

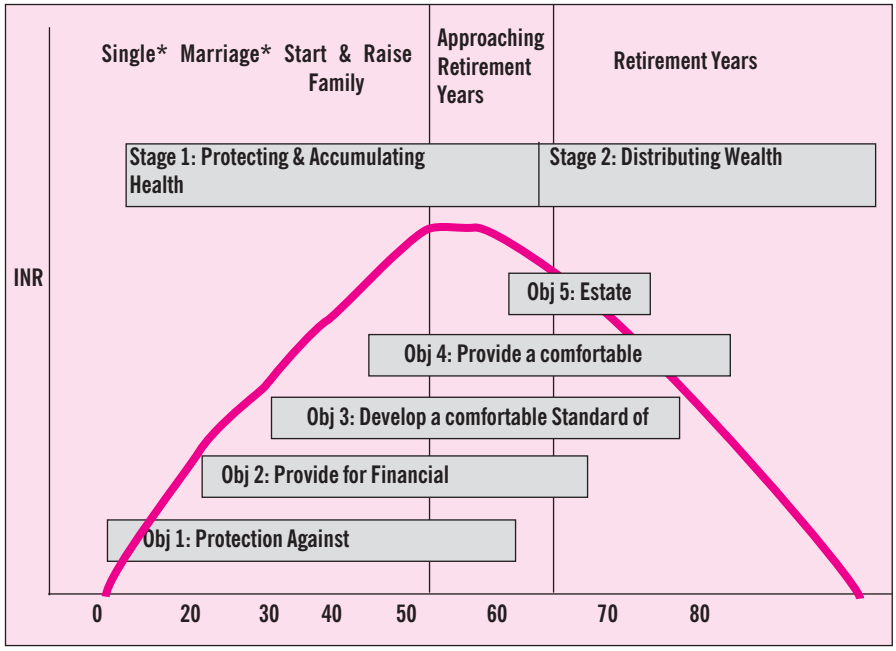
What is Financial Life Cycle Planning?

Financial Life Cycle Planning is based on the premises that we all need to think about our financial lives over a long time horizon. Individual financial needs keep changing with time. While typical financial lifecycle pattern is seen to emerge in most cases, yet there are certain contingencies and risk to which most families are subject. These contingencies, which are difficult to predict cannot be foreseen and hence cannot be planned for the financial life cycle.

There are certain commonalties in a typical financial life cycle such as the need to protect our family against risk; accumulate wealth; and distribute our wealth and provide for an orderly transition of our assets. Lifestyle situations will affect our financial situation and requirements at different stages in life. The lifestyle situations include but are not limited to Marital Status, Employment Status, Age, and Number of Dependents, Economic Outlook, Education, and Health Status.

Although each person sets specific financial goals throughout one's life cycle, five basic financial objectives apply to most people .

Figure 1. The Personal financial Objectives



Years of Age

Based on the Graph prepared by Gail M Gordon of Wyoming University Corporate Service Extension

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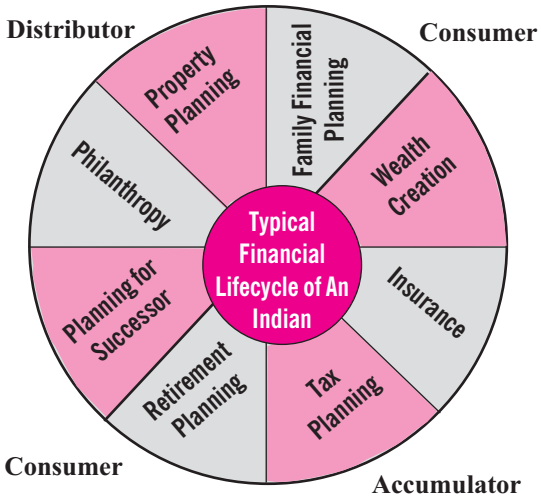
- *Objective - 1.* The first financial objective is to protect ourselves against risk by adopting two basic strategies. The first strategy relates to protection against risk of the unexpected by setting up emergency funds. The second one is to hedge risk by purchasing an adequate mix of insurance that will cover life, disability, health, property and casualty etc.
- *Objective - 2.* The second financial objective is to provide for the financial security of our family and ourselves. This may include providing financial security for extended family members, providing partial or full financial needs for education of family members, purchase of home, cars, and other basic needs. The objective is to provide adequate financial security without placing undue stress on our resources to cause financial crisis.
- *Objective - 3.* The third objective is to have a comfortable standard of living that goes beyond the financial security provided for in Objective 2. We might want to have some of the added benefits of life such as vacations, memberships in clubs, entertainment and relaxation, a second home, additional cars, and time from work to pursue other interests.
- *Objective - 4.* The next objective is to provide for a financially independency, comfortable retirement during our later years that will provide the same standard of living that we enjoyed during our working years.
- *Objective -5.* The final objective is to provide for an orderly transition and distribution of our assets and wealth. This objective is usually called "estate planning" and should be an important objective irrespective of whether we have accumulated a large estate or not.

Personal Financial Planning of Indians

These days, though Indians are trying hard to save money, however the balance may still be smaller than it was a few years ago. At the same time, their personal goals are getting closer – hence there is a need for financial life cycle planning.Out of all the components of Financial Life Cycle shown below, there are certain items, which are specifically applicable for Indians. These items have been discussed below :

Figure 2: Typical Financial Lifecycle of an Indian



Fixing of Retirement Plan

Saving for retirement is probably Indian's biggest financial goal.

Opening up of Indian Insurance to private sector has given us opportunities to choose. A healthy competition has developed amongst Insurance Companies to provide better benefits at a lower cost to the insurers.

However, due to continuus downward trend of interest rates vis-à-vis increasing trend of inflation creating little amount of saving for future.

Meanwhile it is important to recalculate how much money we need to save. If our investments have not performed as expected - we cannot continue on the same savings path we plotted in the 1990s. We will probably need to boost our contribution to get back to where we hoped to be. Reassessment of our saving goals and generating new retirement Planning Programs (if required) do a much better job of pinpointing our retirement saving needs and explaining the risk associated with it. It helps in determining the probable mitigative measures for any future economic downturn in India.

The earlier we make adjustments, the less money we will need to add to get back on track. And we won't have to come up with nearly as much if we make the most of the tax benefits created specifically for retirement savers, which have improved significantly over the past few years.

Therefore we can conclude that, we should not give up. We cannot reach our retirement goals if we stop investing now. We should continue to contribute as much as possible to our retirement plan, invest aggresively as we have more than a decade until we need the money, and make the most of the tax advantages – which save our money, no matter what happens to our investments.

Organising Education Expenditure

Now-a-days education has become one of the costliest livelihoods in India. Based on the current fees charged by Indian School, one has to pay near about Rs. 1 lakh (Rs. 1,00,000) per year per child for any standard private schooling, which reduced to half in case of public schools. For private Engineering Colleges the cost of education will be around Rs. 5 lakhs (Rs. 500,000) in 4 years, which goes down marginally in case of graduation in other subjects and goes up substantially in case of medical graduates. In public colleges however the cost is lower (though not as low as it was 10 – 15 years back). In this context it is worth to mention that, all the above mentioned cost are exclusive of other associated costs like school bus fees, hostel charges, cost of books etc.

The best strategy for reaching our educational goal is to save early and often. The more money we can set aside when our child is young, the less we will have to invest to reach the same goal. If we will start saving at a rate of Rs. 2000 per

month from the baby's birth, and the saving earns 8% per annum (monthly compounding), we will have around Rs. 10 lakh (1 million) before taxes, when the child will grow upto 18 years, the age of completing high school and starting college.

Another most popular source of fund for higher education (mainly at post graduation level) is loan from different commercial banks operating in India. It is available at softer terms and can be considered as a deferred liability. Since, in case of educational loan, the loan is being issued to the student concerned with initial moratorium period of 2 to 3 years depending on the length of course and with a condition that, after completion of the course, the student concern will repay it from his / her salary. Here, the parents / guardians will act as guarantor only. This system not only protects the parents / guardians from a huge expenditure, the candidates himself / herself can enjoy the tax shield on the loan repayment.

Reassessment of our saving goals and generating new retirement Planning Programs (if required) do a much better job of pinpointing our retirement saving needs and explaining the risk associated with it.

Because of these new tools, every one should review their saving strategies. The approaches we have been using may be outdated compared to powerful new option. It could be a good time to switch out of them.

Arranging for Home

While stocks have been in the gutter, bank interest rates are falling, housing values have been booming (though in some of the cities of India the real estate values are falling). This is relieving news if we already own a house, but a tough situation if we have been saving for one.

But we can still buy a new house, even during tough times. There is one big thing working in our favour: the housing loan interest rates are fluctuating on a regular basis (at a comparatively lower level), easy availability of home loans etc. Now-a days in India, it is less expensive to borrow money and easier to get a loan. Lenders are becoming more lenient – letting us slide with lower down payments, higher loan limits and offering options that let us maximise our cash flow. Therefore, instead of saving for home, it's much easier to shop around for loans, making use of low interest rates and get the best deal so that we can buy a home soon.

Expenditure on Health

In India one of the largest personal expenditure is in health protection. The medical expenditures specifically after retirement becomes a difficult affair for Indians, due to extremely low level of governmen-

tal support (lowest in the world, under the comparable situation) in the public health expenditure/ health infrastructure creation and lack of social safety net.

Making contingency plan for medical expenditure is also a difficult task for the middle and low-income group Indians. The probable solution may be to take up medical insurance plan and opting for non-money transaction schemes. Otherwise realization of medical expenses from insurance companies (subsequent to incurring it) is a really difficult job in India.

Lowering of Cost as a Source of Fund

Actually, there may be plenty of extra money that we could easily access without making any sacrifices. We just need to know how to get it. The following section of this article will discuss some of the ways to create extra fund under Indian situtation -

(i) by eliminating expensive debt.
(ii) Making the most of our tax deductions.
(iii) Cutting our insurance cost.

Elimination of Expensive Debt

No matter what our goals are, our very first priority should be to eliminate high – interest debt, which can sabotage our other plans. If our funds are limited, we can't afford to waste money on interest when we are struggling to save for more important goals.

Fortunately it's a great time to get out of debt. Since interest rates are near their 20 years low, we have many opportunities to trade in our high interest debt for less expensive versions. Even if we can't afford to increase our payments, lowering our interest rates will stretch our money further and help us to get out of debt faster. And as soon as debt disappears, we will have much more money available to get our long term savings and investing plans back on track.

Fulfilling financial requirements through loans is easier to fund, however, it creates increasing amount of liability on individuals, which in turn sometimes leads to negative net-worth of Indian individuals. Hence, when we reassessed our goals, we may have discovered that we need to boost our savings significantly.

It is a good time to look at all types of debt – whether it's credit cards, student loans, car loans or personal loans and see what we can do to lower our rates. Start by attacking the loans with the highest rates first, especially if the interest is not tax deductable (For example housing loan interest payment is tax deductable item). That usually makes credit cards our first assignment to eliminate.

Lowering of Tax Bill

Many people accidentally overpay the government because they do not realise how much tax write-offs they can take. Tax credits are even more valuable not only because they shrink our tax bill, but also it is easy money, it is our own money. We do not need to cut down on our spending we just need to know the Indian Income Tax Rules.

Reduce Insurance Cost

In India no body likes to think about insurance. One of the major reason may be, we are overpaying our premium. Opening up of Indian Insurance to private sector has given us opportunities to choose. A healthy competition has developed amongst Insurance Companies to provide better benefits at a lower cost to the insurers. It is not unusual for one company to charge us more money (as premium) than another for the exact same coverage. And some people pay those high prices because they do not know about their alternatives.

Taking the time to review our coverage is one of the easiest ways to freeup more cash without having to make any sacrifice. Hence we can save thousands of rupees on our insurance premiums – just by shopping around, streamlining our coverage and eliminating insurance we do not need.

The Consequences

Fulfilling financial requirements through loans is easier to fund, however, it creates increasing amount of liability on individuals, which in turn sometimes leads to negative net-worth of Indian individuals. Hence, when we reassessed our goals, we may have discovered that we need to boost our savings significantly. But that's tough to do during these difficult economic times – or so it seems, especially, if suddenly our earning stops (mainly in case of closing down of business and

VRS/ERS/ESS) or have an emergency that could eat up big chunk of our funds.

Therefore, at this juncture of time not only we have to figure out how to live with our income, but also we need to make important decisions that can affect our financial situation for years. If we are not prepared, we could commit major mistakes – like raiding our retirement plans or racking up high interest debt – that could derail our long term plan.

The Contingency Plans

The more we do now to prepare, the better our finances will survive. The following strategies may help us by protecting our savings, lowering our bills when our regular flow of income is interrupted or there is a sudden threat of huge personal expenditure –

(i) Building of Emergency Fund.
(ii) Strategy for becoming self employed/starting of Freelance work.
(iii) Lowering of Health & Life Insurance Premium.
(iv) Make the most use of tax benefits.

These defensive strategies should help us to reach our goals no matter what ends up happening and help us to avoid the troubles further.

Indian Social Structure and Financial Needs

As far as Indian social structure is concerned the life cycle began with a young single, working person living independently, subsequently moving through the various stages of marriage and child rearing and ending as a retired couple (most of the cases no adult children at home). The following table indicates the several stages in the family life cycle and the banking needs are most likely to be experienced at each stage.

Stage	Financial Situation	Banking Needs
Young, Single People	Few financial burdens; recreation oriented	Low cost checking, auto loan, credit card
Newly married with child under 6	Home purchasing peak; liquid asset low;	Home loans, car loans, credit cards, revolving credit card loan, bill consolidation loan
Matured couples with dependent children	Good financial position: most of the cases husband wife both earning	Home loans, personal loans, equity credit lines, certificates of deposits, money market deposits account, other investment services
Empty Nest: Old couples, no adult children at home, one or both retired	Significantly reduced income	Rollover, Monthly income cheques on CDS and retirement benefits, estate planning and other social security measures .

Note: Not all possible life cycle stages are included.

Conclusion: Personal Financial Management Pyramid for Indians

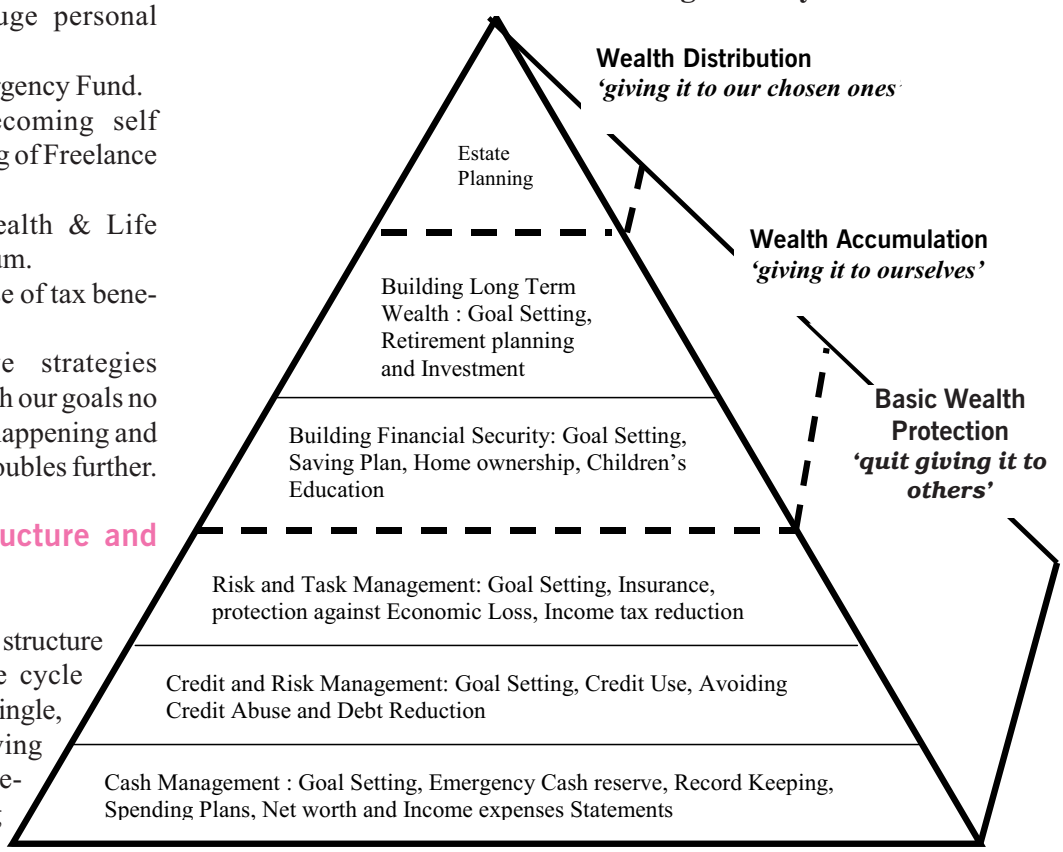


Figure 3: Personal Financial Management Pyramid for Indian

Based on the Model Prepared by Gail M. Gordon, University of Wyoming Cooperative Extension Service, 2001

Our ultimate aim is to draw a suitable and well balanced financial strategy for Indian individual finance. The best way for deriving strategy is developing financial management pyramid. The pyramid follows the typical individual's life cycle, starting with the basic financial requirements at the bottom of the pyramid to establish strength and stability for a healthy financial foundation, and moving up the pyramid to the top where distribution of wealth to one's chosen beneficiaries is the final financial strategy.

Each lower step gradually leads to its upper level. The success of every level is depending on the efficiency of managing its immediate lower level. Decisions about one level have a strong impact on what is done at each higher level of the pyramid. For example, if we have not established a realistic spending plan, we may have a difficult time when it comes to using credit wisely and not spending more than we earn, which subsequently will have an impact on our saving. Our financial life becomes more complex as we move up the pyramid. The financial complexities and the changes in our life may require re-evaluating our strategies and setting new financial goals periodically.

Therefore, the time has come to think about our personal Financial Life Cycle Planning seriously. Directly or indirectly we are engaged in financial life cycle planning, however, now we have to focus more professionally. Any wrong decision can have disastrous effect on our life which will influence our dependent also. Therefore to avoid any such kind of catastrophic circumstances to develop sound financial conditions this is the high time to have our personal financial life cycle planning in place. ■

NEW PUBLICATION

Guidance Note on Accounting for Employee Share-based Payments

The Institute of Chartered Accountants of India has issued 'Guidance Note on Accounting for Employee Share-based Payments'. The Guidance Note establishes financial accounting and reporting principles for employee share-based payment plans, viz., employee stock option plans, employee stock purchase plans and stock appreciation rights. The Guidance Note is a comprehensive document that deals with various significant aspects of such plans including those related to performance conditions, modifications to the terms and conditions of the grant of shares or stock options, reload feature, cash-settled employee share-based payment plans, employee share-based payment plans with cash alternatives, graded vesting, earnings-per-share implications, accounting for employee share-based payments administered through a trust, etc. The Guidance Note also recommends detailed disclosure requirements. The appendices to the Guidance Note provide detailed guidance on measurement of fair value of shares and stock options, including determination of various inputs to the option-pricing models and examples to illustrate application of various principles recommended in the Guidance Note.

The Guidance Note is priced at Rs. 75/- and is available for sale at the sale counter of the Institute at New Delhi as well as at its regional offices located at Chennai, Mumbai, Kolkata and Kanpur. The Guidance Note may also be obtained by unregistered parcel by paying postal and handling charges of Rs. 19/- (Rs. 17/- may be added extra, if required by registered parcel).

Postponement of Effective Date of Mandatory CPE to All members in service in industry, or engaged otherwise than in practice from 1.1.2005 to 1.1.2006

Members may please refer the announcement of the Institute appearing at page number 384 in the September 2004 issue of the Chartered Accountant Journal regarding the applicability of mandatory CPE to members of the Institute who are not in practice.

In terms of the decision taken at the 247th meeting of the Council of the Institute, the Effective Date of Mandatory CPE to all members in service in industry, or engaged otherwise than in practice has been postponed from 1.1.2005 to 1.1.2006.

For detailed guidance on the Continuing Professional Education requirements of the Institute, please visit the Institute's website at http://www.icai.org/knowledge/cpe_main.html