Introduction to

Financial Planning

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CHAPTER 1:
What is Financial Planning ?

Financial planning is defined as the process of meetings one's financial aspirations in life by expert management of finances.

Financial Planning provides you with a blueprint which helps you realize all your dreams in life in a very systematic and planned manner without causing you any sleepless nights.

Remember, financial planning is a process, not a product.

It gives you the confidence that you know you are on the right track and in safe hands and that you will have the money when you need it - when you want to buy a house or a car or when you want to get your daughter married or send her off for education. Or when you retire.

Imagine the personal and social loss if you cannot meet these aspirations because you did not plan well in advance.

Financial Planning combines the elements of risk management, investment planning, tax planning and retirement planning to comprehensively plan for your future needs.

It is a long term process of wisely managing your finances so that you can achieve your dreams, while at the same time mitigating the financial challenges that arise in your lifetime.

Why can't investors do financial planning ?

To answer that question, think what would you do if you were to meet the below aspirations in your life.

- Accumulate 10 lakhs INR 15 years down the line to get your daughter married ?
- Retire at 55 years of age ?
- Purchase a house in 5 years time and save money for it's down payment ?

To achieve all these dreams that you have, you need to have a plan in place that needs to be followed month on month, year on year - diligently !.

Investors seldom do that and get bogged down by the short term financial needs of the household - buying a consumer durable, going on a short vacation or arranging money for next month's loan payment. The long term planning of goals is forgotten and buried deep.

The general perception is that everything will take it's own course and things will fall in place. Over a period of time, investors lose the momentum, direction, zeal and discipline to stay on course to achieve their dreams.

Not to mention the fact that holistically planning your financial goals and parking your money in the right investments is the job of an expert who has the right financial knowledge.

The Financial Planning process is a 6 step process as explained below.

The financial planner and the investor define their relationship and scope of engagement.

The investors' data [assets, liabilities, income, expenses and financial goals] is collected by the planner.

Assessment of current financial condition of the investor is done by the planner.

The planner then analyses the inputs and makes a comprehensive financial plan and presents it to the investor.

All recommendations by the planner are implemented by the investor.

Monitoring and tracking is done by the planner or investor to stay on track to achieve the financial goals.

Here is the 6 step process explained diagrammatically.

This logical 6 step methodology works wonders if you follow it to the Tee. The process assesses how well you are prepared to reach your financial dreams without curtailing routine lifestyle needs.

CHAPTER 2:
Setting Financial Goals

Setting goals that you want to achieve provides a vision and clear focus to your entire life.

You should write down whatever you want to achieve and then prioritize them so that you can target those first which are more important.

“ Goal Based Investing is the holy grail to systematically planning to achieve a short term, medium term or long term goal.

Steps to be followed in goal based investing.

Step 1 - List down all your future financial goals - these are occasions when you need a large sum of money.

Step 2 - List down the time frame as to when these will occur.

Step 3 - Document the current expense for these - how much you need to spend if this goal were to happen today.

Step 4 - Calculate the future value of this goal with an inflation figure.

Step 5 - Calculate how much you need to save each year/month for this goal. For this you will assume a rate of return which will depend on how far your goal is and which investment method you chose.

Attributes of goals

Your goals should be SMART.

S - Specific. If goals are not specific, they are just dreams.

M - Measurable. You should be able to assign money values to goals.

A - Attainable. Goals should be such that you can achieve them.

R - Realistic/Relevant. Unrealistic goals will only lead your financial plan astray.

T - Time Bound. Goals should have a time frame in which they need to be achieved.

SMART Goals

CHAPTER 3:
Ingredients of financial planning

While you do financial planning and adopt the goal based investing approach, there are some ingredients you need to be aware of to help you make things easier.

Follow these tips and you will never go wrong with your aspirations in life.

Understand long term investing

Studies have been done on the Sensex (Bombay Stock Exchange Sensitive Index) returns since the time of its inception in March 1979 when it started at 100 units. The studies reveal that if someone held the Sensex for a year (buy Sensex on any day and sell exactly after a year), then his average returns would be 29%, however, his maximum return and minimum return would vary between 260% to -45%.

If the holding period is taken as 5 years, his average returns would be 25%, however his maximum return and minimum return would now look like 50% to -5%. What this means is that if the investor held onto equity for more years, his risk became less, that is, his chances of losing money became less.

If held for 12 years, there is no risk at all - that is, the investor will not lose his money at all. For 15 years, the average return is around 15% with maximum return as 27% and minimum as 8% (plus 8% !!). That is the power of equity.

This shows that if equity is held for longer term, the probability of losing money is zero and that of making money is positive.

Starting early is the key

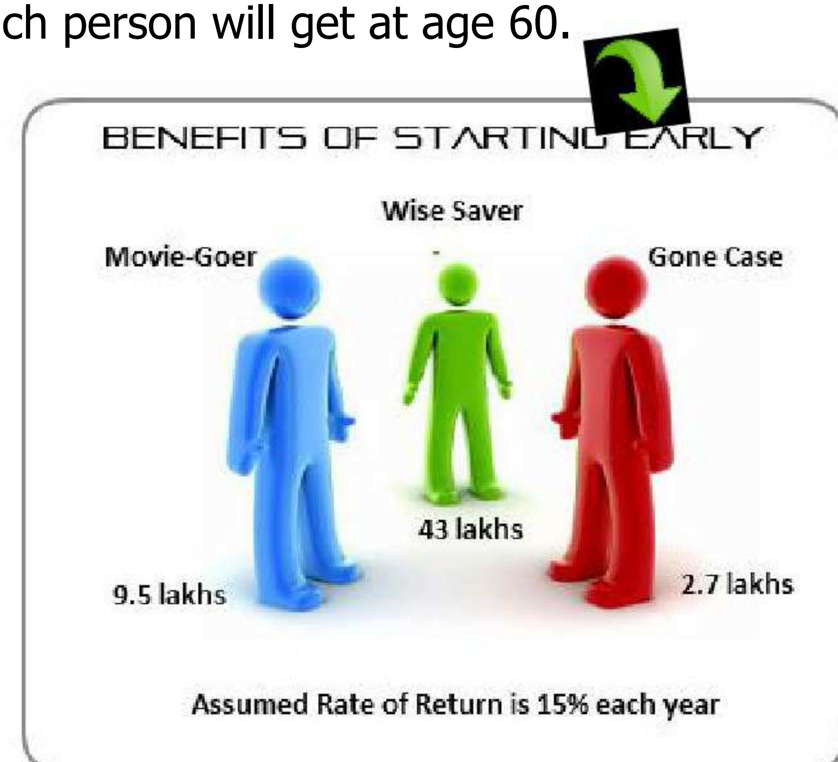
- Suppose Mr Wise-Saver is 30 years old and decides to save till he works (say 60 years of age). However, he can only invest Rs 10,000 each year.

- On the contrary, Mr Movie-Goer can save more but hasn't really started till he reaches age 45. With 15 more years to go before retirement, he realizes he has to rack up money. He decides to put in Rs 20,000 each year, double of what Mr Wise-Saver puts in.

- Lastly we have Mr Gone-Case, who doesn't really care about saving - he wakes up at age 55 and thinks that investing Rs 40,000 each year will do him good. Let's compare what each person will get at age 60.

- The power of compounding works its magic over a long duration of time and produces massive wealth.

- START NOW !



Do budgeting each month

- Personal budgeting or home budgeting is about forecasting your spend and then tracking it against the spends that you actually do so that you are aware of how your money is flowing in and out.

- To begin with, list all your sources of income - salary from employer or earnings from business, dividends, rental income, bonus, interest from investments etc. etc.

- Know where you are spending all your money. Expenses can be divided into discretionary and non discretionary expenses.

- Non discretionary expenses are those that you must spend each month and cannot do without. These include groceries, rentals, insurance premiums, bills, clothing, education, transportation among many others.
- Discretionary expenses include entertainment, dining out, gifts, vacations, hobbies and other recreational spends that can be curtailed and reduced.

- After you have established what your home budgeting looks like, track the actuals to see how much your variance was from what you had wanted to spend. Improvise over a period of time.

Differentiate between needs & wants

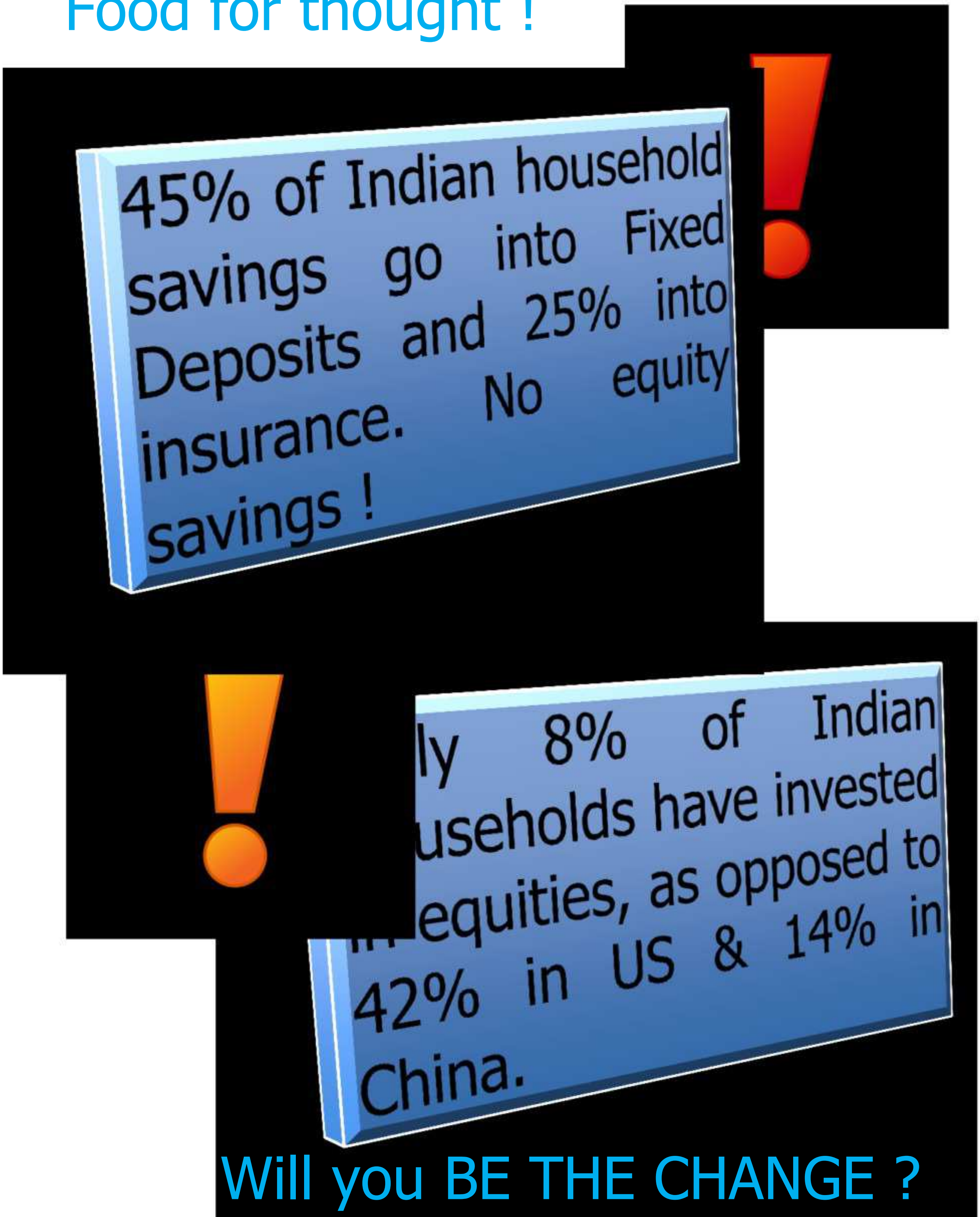
- The basic definition of a need is something which you absolutely must have in order to live. That could be food, shelter and clothing.

- A want is something which you desire to have but without which you can still live. If you don't lay your hands on a want, you will still survive.

- An expensive watch
- A holiday every month
- An expensive car
- A luxurious house

- Education expenses for children
- Basic health care for family
- Clothing for family
- Expenses on food
- Household maintenance expenses like electricity and water

Food for thought !



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