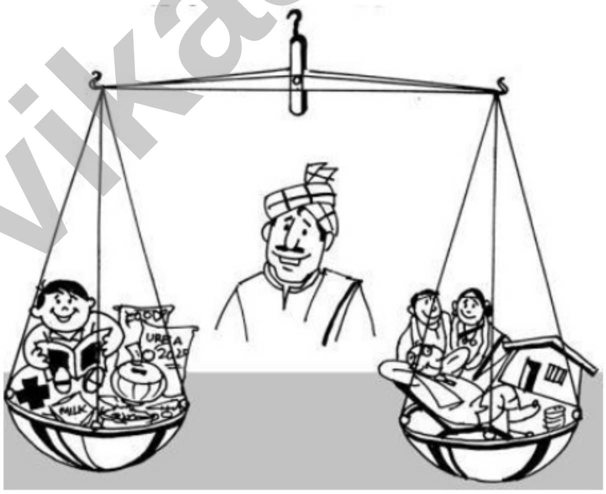
Factors that Influence Financial Planning



- Financial planning is an exercise that has to be unique and suitable to each person – we cannot simply take one person's financial plan and copy it. Our financial plan must be based on our unique personal factors and the external factors around us.
- A financial plan has to be simple – Every goal must have as few financial products as possible aimed at meeting it. For instance, Karim could have taken some money from his father to set up his business but he chose to use only his wife's salary to repay the loan.
- We must always set realistic goals – Karim was confident that the cybercafé would eventually be able to pay for itself. So, although Lata's salary was required to take the loan and pay off the initial repayment instalments, he could pay back the rest from the profits of the business.
- We must ensure an adequate mix of financial products – Whenever we plan for a goal, especially a long term goal, we must make use of a principal called diversification. This means that our money should be spread across more risky and less risky investment products. This is because more risky products have a chance of giving us good returns and less risky products may give us lower returns but at least they give us the assurance that our money is safe.

- **Risk profile:** Some people are naturally more comfortable taking more risk than others. If

- **Risk profile:** Some people are naturally more comfortable taking more risk than others. If we feel that we are 'risk averse', meaning we do not like to take risk, even if our financial plan requires it, we must avoid too much investment in risky products. From childhood, Karim was always more ready to take a risk than Vignesh and as a result, he could take on the risk of doing business while Vignesh preferred working for a company.
- **Age:** Age is an important factor while choosing investment products. When we are young, we can choose more risky products because we have time on our side. Risky investments usually pay off in the long term. Also, if something goes wrong and we lose some of our capital when we are young, we can rebuild it over time. When we are older, we should invest in safe investments even if they give low returns. This may have been the reason why Karim did not expect his father to invest in his new and risky idea of setting up a cybercafé in the village.
- **Number of dependents:** Vignesh was the only earning member of his family, so he cannot afford to take many risks with his income. Karim, on the other hand, had the support of his wife's income and his father's and brother's earning ability. He could afford to take a risk while investing.

- **Economic growth in the country:** Countries go through economic cycles. This means that there are a few years during which a country will grow at good rate and then it will be followed by a few years of slightly slower growth. If a country is growing well, businesses do well. As a result, stock prices increase. On the other hand, interest rates and inflation remains moderate. When a country is in a down cycle, stock prices are relatively low and interest rates and inflation start to increase.
- **Political issues:** When a country enjoys political stability, the economy prospers. Although both growth and social issues are equally important, there are certain political parties that give more importance to the former and others that give more importance to the latter. As a result, the political party in power has an impact on the performance of stocks and other financial products.
- **Interest rates:** Interest rates determine the rates at which businesses borrow and lend to the banking sector and other lending institutions. Usually, when business people want to borrow more money to grow their businesses, interest rates in the market increase. Another important factor that impacts interest rates is inflation. When inflation is high, the RBI may increase the interest rates to bring inflation down. There are other factors that affect interest rates too.
- **Inflation:** The rise in prices is broadly referred to as inflation. If inflation and interest rates are high, businesses are likely to show lower profits and therefore their prices on the stock

exchange are likely to fall. The reverse is usually true too.

- Inflation also has a direct impact on the way we plan for long term goals. If inflation is high, we expect the cost of the goal in the distant future to be higher and we have to invest accordingly, and vice versa.
- **Global issues:** Our economy is affected by many global issues. If prices of oil rise internationally, we face higher fuel prices too. Directly and indirectly this pushes inflation upwards. Also, since money flows between India and the rest of the world in the form of investments, if countries abroad are facing problems, it impacts their investments in India and vice versa. As a result, the fate of the global economy makes our stock markets move up and down and finally could impact businesses.
