Financial Planning

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Content

Definition & Meaning

- Process of developing a personal roadmap for your financial well being.

Definition & Meaning

- Inputs –
  - your finances, i.e., your income, expenditure, assets and liabilities
  - your goals, i.e. your current and future financial needs
  - your appetite for risk

- Output –
  - personal financial plan –
    - that tells you how to use your money to achieve your goals, keeping in mind inflation, returns and taxes.

Definition & Meaning

- Financial planning is the process of systematically planning your finances towards achieving your short-term and long-term life goals.

Definition & Meaning

- Energy can neither be created nor destroyed.

However……

- Wealth can either be created Or destroyed.
- Proper Financial planning is a way towards wealth creation.

Need & Objective

Asset / Item	Rate /per	1950	1975	2000	2021 /25	2040 / 50
Gold	10 gm	< 100	540	4400	50000	?
Real Estate-1	SF.		1000	5000	40000	?
Real Estate-2			100	2000	20000	?
2-Wheeler	Unit		8000	35000	65000	?
4-Wheeler	Unit		50000	200000	450000	?

Need & Objective

Asset / Item	Rate / per	1950	1975	2000	2021 /25	2040 / 50
Newspaper	Unit	0.13	0.75	2	5	?
Petrol	Lit.	0.30	N.A.	26	100	?
Diesel	Lit.	0.10	N.A.	14	90	?
Flight (DM)		150	500	2500	9000	?
Movie Tk.	Unit	0.30	2.00	50	300	?
Milk	Lit.	0.15	4.00	15	75	?

Need & Objective

Asset / Item	Rate	1950	1975	2000	2021 /25	2040 / 50
Mobiles	Unit	N.A.	N.A.	20000	15000	?
P.C.	Unit	N.A.	100000	30000	30000	?
Laptop	Unit	N.A.	N.A.	70000	30000	?
T.V.	Unit	N.A.	N.A.	10000	30000	?
Washing M/c.	Unit	N.A.	N.A.	10000	25000	?

Need & Objective

Who needs financial planning?

- Age – 23 / 25 / 35 / 50 / 70
- Gender – Male, Female
- Profession – Service, Business, Artist, Sportsman
- Status – Poor / Rich

Need & Objective

Why financial planning?

- Goals & Aspirations – Personal Life & Career
- Risk Cover – Life, Health
- Unforeseen Situation – Loss of job, Accident
- Beat the inflation
- Income after retirement

Benefits of Financial Planning

- Helps monitor cash flows and reduces unnecessary expenditure.
- Enables maintenance of an optimum balance between income and expenses.
- Helps boost savings and create wealth.
- Helps reduce tax liability.
- Maximizes returns from investments.

Benefits of Financial Planning

- Creates wealth and ensures better wealth management to achieve life goals.
- Financially secures retirement life.
- Reviews insurance needs and therefore also ensures that dependents are financially secure in the unfortunate event of death or disability.
- Lastly, it also ensures that a “will” is made.

Financial Goals

- Short term : (< 1 year)

- Basic Living Expenses (Food, Clothes)
- Monthly Bills (Maintenance, Electricity, mobiles)
- Other Purchases
- Entertainment, Travel
- Daily expenses, conveyance
- Rents
- Monthly premiums (LIC, Health Insurance)
- Contingencies

Financial Goals

- Medium term : (1 to 5 years)

- Down Payment for Car, house
- Mobiles, Laptops / PC
- Household Appliances (TV, Washing M/c., AC)
- House repair, Renovation, interiors
- Foreign Travel
- Contingencies

Financial Goals

- Long term : (> 5 years)
- Car
- House
- Marriage
- Children's education
- Medical Expenses (Self, Family, Parents)
- Children's Marriage
- Retirement
- Contingencies

Concepts

- Savings Formula
- Time Value of money
- Rate of Return, Required rate of return, Real rate of return
- Risk & Returns
- Present Value & Future Value
- Rule of 72
- Power of compounding
- Annuity

Concepts

- Savings Formula?
- Income – Expenditure = Savings
- Income – Savings = Expenditure
- Spending is easier than saving

Concepts

- Time Value of Money

A rupee today is not the same tomorrow.

Concepts

- Interest Rate :
  - Simple interest
  - Compound interest

Concepts

- Rate of Return
- Required (Expected) rate of return

  = Risk Free rate + Risk Premium
- Real rate of return

  = Actual rate of return – Inflation rate

Concepts

- **Risks**

Risks of :

- Lower returns than expected (Inflation rate, Interest rate)
- Losing the principle (Default risk, Market risk)

Concepts

Risk & Returns

- High Risk, High Returns
- Low Risk, Low Returns

Concepts

- Present Value
- Future Value
- Discounting Factor (DF)
- Compounding Value Factor (CVF)

Concepts

- Present Value (PV)

$PV = FV/(1 + r)^{n}$

PV - Present Value

FV - Future Value

r – Rate of interest

n – no. of years

$1/(1+r)^{n}$ - Discounting Factor

Concepts

e.g.

FV = Rs.110 after 3 years

Interest rate = 8% What is PV ?

PV = $110 \ / \ (1 + 0.08)^3$

= 87.32

Discounting factor - $1/(1+r)^n = 1/(1 + 0.08)^3 = 0.7938$

Concepts

- Future Value (FV)

$FV = PV * (1 + r)^{n}$

FV - Future Value

PV - Present Value

r – Rate of interest

n – no. of years

$(1+r)^n$ - Compounding Value Factor

Concepts

e.g.

PV = Rs.100

Interest rate = 8%   What is FV after 3 years?

$FV = 100 * (1 + 0.08)^3$

$= 125.98$

Compounding Value Factor - $(1 + r)^n = (1 + 0.08)^3 = 1.2597$

Concepts

- Rule of 72

No. of years to double your money

= 72 / expected rate of return

Concepts

Power of compounding

Consider a chess board (64 squares)

If you place 1 wheat grain in 1st square, & go on doubling in each next square, i.e. 2 in 2nd square, 4 in 3rd square & so on…….

How many food grains would be there in 64th square?

92,223,400,000,000,000,000

Power of compounding

Retirement age	60
Monthly Saving	1000
Annual Saving	12000
Int. Rate	7.00%

Age	Years of Investment	Maturity Amt.
23	38	2215683
28	33	1527105
35	26	881806
40	21	576069
45	16	358083

Power of compounding

Retirement age	60
Monthly Saving	5000
Annual Saving	60000
Int. Rate	7.00%

Age	Years of Investment	Maturity Amt.
23	38	11078417
28	33	7635526
35	26	4409029
40	21	2880344
45	16	1790413

Power of compounding

Retirement age	60
Monthly Saving	1000
Annual Saving	12000
Int. Rate	10.00%

Age	Years of Investment	Maturity Amt.
23	38	4805373
28	33	2933720
35	26	1441199
40	21	844833
45	16	474536

Power of compounding

Retirement age	60
Monthly Saving	5000
Annual Saving	60000
Int. Rate	10.00%

Age	Years of Investment	Maturity Amt.
23	38	24026867
28	33	14668602
35	26	7205997
40	21	4224165
45	16	2372682

Power of compounding

- Multiple period compounding
- Effective interest rate

Power of compounding

- Effective interest rate (EIR)

Effective Annual Interest Rate = $\{ 1 + (r / m) \}^{m} - 1$

m – Periods of compounding

e.g. If interest rate is 8% compounded quarterly,

EIR = $\{ 1 + (0.08 / 4) \}^{4} - 1$

$= 0.0824$ i.e. 8.24%

Power of compounding

- Effective interest rate (EIR) for multiple years

EIR for multiple years = $\{ 1 + (r / m) \}^{n \times m} - 1$

m –Periods of compounding

n – no. of years

Concepts

- **Annuity**

Annuity is a Fixed Amount (payment Or receipt) each year for a specified no. of years.

e.g. Rent, EMI, Insurance Premium

Pension

Concepts

- **Annuity**

(Annuity - Deposited at the end of each year)

Future Value of Annuity (FVA) = $A * \{ (1 + r)^{n} - 1 \} / r$

A – Annuity
r – Interest rate
n – no. of years

Compounding Value Factor of Annuity (CVFA) =

$$= [\{ (1 + r)^{n} - 1 \} / r]$$

Concepts

- **Annuity**

(Annuity - Deposited at the beginning of each year)

Future Value of Annuity (FVA) = $A * [\{ (1 + r)^{n} - 1 \} / r] * (1 + r)$

A – Annuity
r – Interest rate
n – no. of years

Compounding Value Factor of Annuity (CVFA) =
$= [\{ (1 + r)^{n} - 1 \} / r] * (1 + r)$

Financial Planning Process

Basic Requirements :

- Bank Account
- Aadhar Card (Address Proof)
- PAN (Permanent Account Number)
- D-mat Account

Financial Planning Process

Considerations :

- Current situation (Earnings, Expenditures)
- Personal Goals (ST, MT, LT)
- Career Goals (Profession, position, transfers & relocation, business plans, moving abroad)
- Current age, Retirement age, Life expectancy
- Gender
- No. of dependents & status
- Taxes
- Risk profile

Financial Planning Process

Assets :

- Physical Assets (Appreciating / depreciating)
  - Land
  - House
  - Art (Paintings, Artifacts)
  - Gold
  - Car
- Financial Assets :
  - Debt (FD, RD)
  - Equity
  - MFs

Financial Planning Process

- **Liabilities**
  - Loans (Short term / long term)
  - Insurance
  - Credit Card payments

Financial Planning Process

- Without a plan, nothing happens
- A Goal without a plan is just wish

Financial Planning Process

- Steps in Financial Planning :

Step 1: Identify your current financial situation
Step 2: Identify your goals
Step 3: Identify financial gaps
Step 4: Prepare your personal financial plan
Step 5: Implement your financial plan
Step 6: Periodically review your plan

Financial Planning Process

Step 1: Identify your current financial situation

- Gather all information about your sources of income, debts, assets, liabilities, etc.
- This gives you a picture of your current financial situation.

Financial Planning Process

Step 2: Identify your goals

- List what are your current and future family goals. Prioritize each goal and put a time period against each, i.e. when will you need the finances to achieve that goal.

- If possible, quantify each goal. This exercise enables recognition of short term and long term goals, and how much money you need for each.

Financial Planning Process

Step 3: Identify financial gaps

- Once you know where you stand financially, and where you want to be, i.e. how much you have or can expect regular sources of income to generate, and how much you need to fulfil various goals.

- A simple calculation gives you an idea of the shortfall. This is important, because, identifying the right investments to cover the shortfall depends on you quantifying the income from your investments.

Financial Planning Process

Step 4: Prepare your personal financial plan

- Now review various investment options such as stocks, mutual funds, debt instruments such as PPF, bonds, fixed deposits, etc. and identify which instrument(s) or a combination there of best suits your needs. The time frame for your investment must correspond with the time period for your goals.

Financial Planning Process

Step 5: Implement your financial plan

- It's now time to put things into action. Gather necessary documents, open necessary bank, demat, trading accounts, liaise with brokers and get started.

- Most importantly, start investing and stick to your plan.

Financial Planning Process

Step 6: Periodically review your plan

- Financial planning is not a one-time activity
- A successful plan needs serious commitment and periodical review (once in six months, or at a major event such as birth, death, inheritance)
- You should be prepared to make minor or major revisions to your current financial situation, goals and investment time frame based on a review of the performance of your investments

Financial Planning Process

Step 6: Periodically review your plan

- Financial planning is not a one-time activity.
- A successful plan needs serious commitment and periodical review (once in six months, or at a major event such as birth, death, inheritance).
- You should be prepared to make minor or major revisions to your current financial situation, goals and investment time frame based on a review of the performance of your investments.

Your Financial Plan

Sr.	Basic Details			Goal Amount			Savings Required	
	Goal Desc.	Priority	Year	Present Val.	Inflation	Future Val.	Monthly	Lumpsum
Short Term:								
Mediim Turm :								
Long Term:								

Tips for Financial Plan

- Start now. it's better to start now than dawdle for another five years. Every day counts.
- Be honest with yourself. Seek help when needed.
- Set sensible, measurable goals for yourself. Be realistic in your expectations of the results of financial planning.
- Review your plan and financial situation periodically and adjust as needed.
- Always review the performance of your investments; pull out if needed and reinvest the money elsewhere.
- Be hands-on. It's your money and no one else will do your work for you.

Discipline in Financial Planning

- Regular
- Systematic
- Patience
- Diversification

ALL THE BEST

for your financial life ahead!

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