Importance of Financial Planning

Can you manage without financial planning? Many people do, but they may find—often when it's too late—that they don't have the means to achieve their life goals. For example, people today realize the importance of living life to the fullest. Consequently, many opt for early retirement from full time jobs, as compared to a few decades ago, when most people worked until the maximum retirement age of 58-60 years.

The average person can today expect to live a healthy life well into his or her seventies or eighties, which means that retirement life is almost as long as working life. Financially, it implies that savings (after taking into account inflation) should be enough, not just to maintain the same lifestyle for almost 25-30 years, with no new income, but also to take care of medical expenses, which are usually high the older a person gets. Planning for all this is a tall order for anyone. That's why it's critical for everyone to plan their finances from an early age.

So, what do you need to know about yourself when thinking about a Financial Plan?

Your financial plan entirely depends upon how much effort you are willing to put in. This means not just having a good handle on the details of your income and expenses, assets and liabilities, but more importantly on the following items:

1. Time Horizon and Goals
2. Risk Tolerance
3. Liquidity Needs
4. Inflation
5. Need for Growth or Income

No doubt there are other factors that are important as well, but we believe that the above five require a more detailed study on your part.

Time Horizon and Goals

It is important to understand what your goals are, and over what time period you want to achieve your goals. Some goals are short term goals those that you want to achieve within the year. For such goals it's important to be conservative in one's approach and not take on too much risk. For long term goals, however, one can afford to take on more risk and use time to one's advantage.

Risk Tolerance

Every individual should know what their capacity to take risk is. Some investments can be riskier than others. These will not be suitable for someone of a low risk profile, or for goals that require you to be conservative. Crucially, one's risk profile will change across life's stages. As a young person with no dependants or financial liabilities, one might be able to take on lots of risk. However, if this young person gets married and has a child, he/she will have dependants and higher fiscal responsibilities. His/her approach to risk and finances cannot be the same as it was when he/she was single.

Liquidity Needs

When do you need the money to meet your goal and how quickly can you access this money? If you invest in an asset to and expect to sell the asset to supply you funds to meet a goal, then please understand how easily you can sell the asset. Usually, money market and stock market related assets are easy to liquidate. On the other hand, something like real estate might take you a long time to sell.

Inflation

Inflation is a fact of our economic life in India. The bottle of cold drink that you buy today is almost double the price of what you paid for ten years ago. At inflation or slightly above 4% per annum, a packet of biscuits that costs you Rs.20 today will cost you Rs.30 in ten years' time. Just imagine what the cost of buying a car or buying a home might be in ten years' time! The purchasing power of your money is going down every year. Therefore, the cost of achieving your goals need to be seen in what the inflated price will be in the future.

Need for Growth or Income

As you make investments, think about whether you are looking for capital appreciation or income. Not all investments satisfy both requirements. Many people are buying apartments, but are not renting them out even after they take possession. So, this asset is generating no income for them and they are probably expecting only capital appreciation from this. A young person should usually consider investing for capital appreciation to take advantage of their young age. An older person however might be more interested in generating income for themselves.

Benefits of financial planning

Here's a list of the benefits that a well chalked out financial plan can bring about:

1. Helps monitor cash flows and reduces unnecessary expenditure.
2. Enables maintenance of an optimum balance between income and expenses.
3. Helps boost savings and create wealth.

4. Helps reduce tax liability.
5. Maximizes returns from investments.
6. Creates wealth and ensures better wealth management to achieve life goals.
7. Financially secures retirement life.
8. Reviews insurance needs and therefore also ensures that dependents are financially secure in the unfortunate event of death or disability.
9. Lastly, it also ensures that a ‘WILL’ is made.