CHAPTER - 1

INTRODUCTION

1.1 Definition of Personal Financial Planning

“Financial Planning is the process of meeting one’s life goals through the proper management of personal finances.” (Kapoor, 2008). Proper Personal Financial Planning leads to Financial Satisfaction and Well-being. As Every person, family, or household has a unique needs and financial position, their financial planning must also be carefully planned to meet specific needs and goals.

According to Hallman and Rosenbloom, Personal Financial Planning is “The development and implementation of total coordinated plans for the achievement of one's overall financial objectives.” Individuals and families have many goals or objectives in life to fulfil. For the same they will have to save, accumulate and grow their money. The common life goals of individuals are: Education and Marriage of Children, Buying a house and a Comfortable Retirement. Other short term goals may include funding vacations, purchasing a car and fulfil debt (home loan, car loan), etc. For achievement of short term or long term goals, proper management of Personal Finance is essential. Financial Planning is all about managing finances of an individual or a family. It means Proper Management of Income, Expenses, Assets, Liabilities, Insurance, Taxation and Estate, so that one can successfully achieve all their desired goals and enjoy financial well-being and hence financial satisfaction.

1.2 Need for Personal Financial Planning

India, post liberalization has experienced much change in terms of Economic Growth and Social Structure. Basically, it serves as a base for the need of robust Personal Financial Planning. Major
factors which are relevant and important for the need of Personal Financial Planning are discussed below.

- **Longer life span and lack of social security**
  According to economic survey 2012-13, the average life expectancy which was around 60 years in 1980-81, has increased to 64.6 (for males) and 67.6 (for females in 2010-11). People live longer now as compared to the earlier generations. Few generations ago, someone would start earning by the time one reached the age of 20 years, work till the age of 58 years and live till around 65 years. In such a case, one earns for 38 years and lives off the retirement savings for the next 7 years. In recent times, one starts working at 25 years of age. Retire at age of 60 years and life span of 80 years. So an individual works and earns for 35 years to support post retirement life of 20 years. Government of India has withdrawn Pension Plans for government employees and introduced New Pension Scheme (NPS), which is defined contribution plan.

- **Proliferation of numerous products**
  Post 1991, after implementation of LPG, many new products and services have been introduced by the Life Insurance Industry, Banking industry and other NBFCs. New financial products like Mutual Funds, Derivatives, Commodities, Portfolio Management Schemes, Non-Convertible Debentures and Unit Linked Insurance Plans have been introduced for the investors. It is difficult for investors to select financial product to tailor their needs.

- **Increasing income and savings levels**
  Indian Economy has been growing at a 6% - 9% rate of GDP growth driven mainly by domestic consumption. According to data, average Gross Domestic Saving was Rs.1067.30 Billion in 1980-81 which has increased to 24819.31 in 2010-11 (RBI). Per Capita Personal Disposable Income was Rs. 23712 in 2004-05 which has increased to Rs. 66281 in 2012-13 (CSO). The educated and urban middle class has experienced increase in income levels. At the same time, unlike our counterparts in many of the developed countries, Asians, and especially Indians believe in saving money. India has a considerable household savings ratio which is more than 25%. Here again investors need guidance to channelize their savings.

- **Increasing level of borrowings**
In today’s financial markets, there is an easy access to loans resulting in increased levels of borrowings by people. If not managed carefully, this may lead to a serious mismatch in earnings and repayment leading to problems in cash flow. Leveraging the low interest rates is a critical aspect which needs to be explained to the borrowers.

**Inflation**

Indians are wise savers but poor investors (Visa 2012). Indians save money into traditional risk free products like Bank FD, Saving Bank Account, Insurance. This may not be sufficient to overcome the impact of increase in inflation. Therefore, a well balanced Financial Plan is required to protect the investors from the impact of inflation.

**Nuclear families & Change in Life Style**

Traditional Indian social system of Joint families provided great safety net for most individuals as it shared the resources and difficulties. Growing urbanisation during the past decades have led to the birth of nuclear families. These smaller families have a need to plan better. They can no longer depend on the support of the larger family since they might be geographically distant. So, one needs a comprehensive financial plan to meet the contingencies and to attain the short term and long term goals.

### 1.3 Components of Personal Financial Plan (PFP)

According to Garman and Forgue (1988) & CPFA – NISM (2009), Personal Financial Plan is the balance of following components:

- Planning Personal Finances
- Managing Personal Finances
- Managing Expenditure
- Protecting Income & Assets
- Managing Tax Planning
- Planning Investments
- Retirement Planning
- Estate Planning
1.4 Process of PFP

According to Gitman & Joehnk (1990) The financial planning process is a logical, six-step procedure. The steps involved are listed below:

- determining your current financial situation
- developing financial goals
- identifying alternative courses of action
- evaluating alternatives
- creating and implementing a financial action plan, and
- re-evaluating and revising the plan.

1.5 Definitions and Concept of Financial Literacy

Various researchers and organizations have provided different definitions of financial literacy. Some of the definitions are discussed here. Financial Literacy is a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well-being. (OECD INFE, 2011). Financial Literacy is concerned with the understandings of basic financial concepts, principles, skills and ability to understand key financial products to make good financial choices. (Jariwala H., 2013). According to PACFL, “Financial Literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being”. Lusardi & Mitchell (2007) have defined it as the most basic economic concepts needed to make sensible savings and investment decisions. ANZ Bank (2008) has defined it as the ability to make informed judgements and to take effective decisions regarding the use and management of money.

1.6 Need of Financial Literacy

Need of financial literacy is increasing significantly with deregulation and globalization of financial markets. More choices are available for investment avenues with easy access to credit cards and personal loan. According to one survey “Indians are wise saver but poor investors.” Saving rate in the country is increasing year by year and on the other hand increase in spending
on consumption and change of life style have led to increase in personal and household debt levels. Countries like India with almost nil social security system provided by government, corpus saved by investors are not sufficient enough to meet the expenses and maintain same life style post retirement. The one reason for the same is, though there are many diversified options available for investors to invest their money, Indian investors still prefer safe options like Bank FD, Post office schemes. Returns generated by these instruments do not beat the increasing rate of inflation. So investors’ financial well-being is hampered. So it is required that investors should not only be aware about financial market and its different components and be more informed about economic variables impacting their financial decisions, they should be able to plan their finances carefully, keeping into mind their own financial goals and objectives. Beal and Delpachitra (2003) had stated that, “the need for financial literacy has grown rapidly over the last decade because financial markets have been deregulated and credit has become easier to obtain, as financial institutions compete strongly with each other for market share.” Financial literacy is important because well informed, well-educated consumers should make better decisions for their families; increase their economic security and well-being; contribute to vital thriving communities; and foster community economic development”.(Hogarth, 2002)

1.7 Approaches to Calculate Financial Literacy

As discussed, financial literacy is associated with financial well-being and financial satisfaction of an individual. Increase in Financial Literacy will help investors to make informed choices, which, in turn, helps nation to build strong financial system and will help to achieve goal of Financial Inclusion. Many government bodies like SEBI & RBI has realized the value of financial literacy and to increase that, they have started various financial education programmes. To design the program for investors, one really needs to know what is the current level of financial literacy that investors possess and then course can be designed to suit their literacy level.

There are different methods adopted by researchers and certain organizations to measure the current level of financial literacy of the investors. Definitions on Financial Literacy provided by different researchers serve as the basis for items to be included in research instrument to measure the financial literacy. Some researchers have developed the scale for Self-Assessment of
Respondents and some have given performance test. Basic items covered in different researches are Time value of Money, Calculation of Interest Rate, Relation between Risk & Return, Inflation, Diversification etc.

Scale used in the present study is adopted from Lusardi & Mitschell (2008) and modified according to Indian context.

1.8 Rationale of the Study

Financial well-being of the individual depends upon Financial Attitude and Financial Behavior which, in turn, depends upon Financial Literacy of an Individual. Many researches have been done in area of Financial Literacy and some of the aspects of investment decision making in India, but there is no comprehensive study so far that deals in the overall personal financial planning aspects of the individual decision making process and/or which has attempted to measure the awareness of overall personal financial plan, attitude of the respondents for the same and factors influencing personal financial planning of an Individual. The present study attempts to fill this gap in the current research.

1.9 Organization of Thesis

Chapter – 1 Introduction

Chapter – 2 Literature Review
The chapter discusses various research studies reported in Journals, periodicals, thesis on Financial Literacy and Financial Plan, need for the same and literature related to various components of Personal Financial Planning. After reviewing these research studies, the research gap was identified at the end of this Chapter.
Chapter - 3 Research Methodology
The chapter discusses the research methodology adopted for the present study, which includes objectives of the study, hypotheses, scope, research design, sampling plan, overview of questionnaire, pilot test, sources of the data, and data analysis tools & techniques.

Chapter – 4 Analysis & Interpretation
The Chapter discusses various tools and test applied on data to obtain the objectives of the research. It discusses descriptive statistics as well as inferential statistics.

Chapter – 5 Findings
The Chapter discusses overall study and highlights the major findings which have been derived from the analysis of data.

Chapter – 6 Conclusions, Major Contribution and Scope for the Future Research
The chapter discusses overall conclusion of the study, beneficiaries and contribution of the study. It also discusses limitation of the present study and provides scope for the future research work.
Part – II

Personal Financial Planning
1.10 Personal Financial Planning Process

Personal Financial Planning is the management of Personal Finance of Households. It includes management of Debt, i.e., Personal Loan, Credit Card etc., Money Management, maintaining liquidity for emergency; obtain short term & long term goals through proper investments (keeping into mind the taxation, i.e., Tax Planning), managing risk of life with Insurance, Planning for safe/comfortable retirement and proper planning of transference of one’s assets after the death. Steps for Personal Financial Planning are listed below:

(1) Determine your current financial position.

(2) Identify financial goals.

(3) Evaluate all the alternatives available.

(4) Create financial plan and make it into action.

(5) Revaluate it periodically and revise, if necessary.

Step 1: Determine Your Current Financial Position
This step includes preparing a personal financial budget. One will list down all their income and expenses, savings, investments and debts. This will create a base to prepare your financial plan.

Step 2: Identify financial goals
Next step involves identifying financial goals of the life. One should remember that goals should be realistic and quantifiable in terms of money. Also attach timelines to the goals. Some of the major and minor goals in an individual’s life are listed below.

Major Long Term Goals in Life can be
• Children’s Education, Children’s Marriage, Purchasing a House, An Independent Retirement

Short Term Goals in Life can be
• Vacations, Purchasing a Car, Purchasing electronic gadgets, paying off the loans.

Step 3: Evaluate all the alternatives available
Taking into consideration one’s current financial position and objectives to attain; one needs to decide the allocation of money in to various alternatives available. There are different investment
vehicles available in Indian Capital Market, like equity shares, FD, Bonds, Mutual Funds, Futures & Options, etc. One can choose the investment vehicle according to once objective, tenure of investment and risk profile of the individual. One should also consider opportunity cost of selecting a particular alternative. Opportunity cost is what you give up by making another choice.

**Step 4: Create financial plan and make it into action**

Next step is to prepare a written Financial Plan. Here, the allocation of money will have to be spelled and written clearly. To implement financial plan, one can take help of Investment brokers, agents or certified financial planners to purchase stocks, mutual funds, insurance etc.

**Step 5: Revaluate it periodically and revise, if necessary**

Financial planning is a dynamic process that does not end when you take a particular action. One need to regularly assess their plan and check whether it is aligned with objectives or not. Changing personal, social, and economic factors may require more frequent assessments.

### 1.11 Components of PFP in details

#### 1.11.1 Money Management

Money management is the day-to-day financial activities needed to manage personal economic resources, while working toward long-term financial security.(Kapoor J., 2008). Money Management includes:

- **Storing and maintaining personal financial records and documents.**
  
  One can prepare home file. In that, one can maintain the records which are often required and can be referred when needed. For example, employment records, tax returns, financial services records, investment statements, copy of insurance policies, bills of consumer purchase, statement of loans etc. Some documents can be kept at Safe deposit lockers, e.g., Birth Certificate, Marriage Certificate, Mortgage Papers, Wills, Insurance policy, Certificate of investments. One can also keep computerized records of personal budget, bank statements, investment statements, tax returns, etc.
• **Creating a personal balanced sheet and cash flow statements**

Personal balanced sheet will include: List of Assets one has, like, liquid assets, real estate, investment assets; Liabilities one has, like, Personal loans, credit card, debts, Home loans etc. Net worth is difference of one’s assets and liabilities. Personal balanced sheet determines your current financial position. Cash flow statements will record inflow of income through various sources like salary, dividends etc. and outflow of income like fixed and variable expenses.

• **Creating a personal budget**

Budget is a plan for spending in the future, such as for the next month, next quarter or next year. Budgeting helps a person to live within their income, reach their financial goals, prepare for financial emergencies, and develop positive attitude towards financial management. Effective budget will help one to achieve their financial goals. Steps to prepare personal financial budget:

1. One can list all their future financial goals.
2. Estimate Income from all the sources.
3. Calculate the amount required for emergency purpose, periodic expenses and financial goals.
4. Calculate the amount required for fixed expenses like home loan installments and variable expenses like normal household expenses.
5. Set budget for savings.
6. Compare budgeted amount of inflow and outflow with actual amount, and determine variance. Take necessary corrective actions in spending pattern to reduce the variance.

1.11.2 **Insurance Planning**

Insurance Planning is determining the amount of insurance cover required by the individual to cover the risk associated with one’s life, medical emergencies and assets.

In case of pre-mature death of the primary earner of the family, the family’s income will stop. In that case, the family will need some source of money which can generate income to cover the expenses and liabilities for the rest of their life. One can purchase Life Insurance policy to
protect their family in the event of death of primary earner. One need to calculate amount required for Insurance Coverage.

One can take up health insurance popularly known as Mediclaim to meet with medical emergency. Assets like house, automobiles and other assets can be protected under Property Insurance. Health & Property Insurance are covered under General Insurance.

**Different Types of Life Insurance Products**

**1.11.2.1 Endowment Plan**

It is a policy with a savings feature. At maturity or in case of death of policy holder, a lump sum amount is paid equal to the sum assured and bonuses. It is considered as more expensive than whole life or term plan. One can choose the term from 5 to 30 years. Endowment insurance is a popular policy, which provides protection to self and family. It also acts as a good tool for retirement planning.

**1.11.2.2 Whole Life insurance**

It is designed to provide life insurance cover for the entire life of the insured. Insured person pay the premium throughout the lifetime. Generally premium amount remains the same throughout the tenure. It is generally used when the need of the life insurance is life-long. The benefits of whole life policies are guaranteed death benefits, fixed annual premiums. The drawback of the same is that, the internal rate of return generated by the policy may not be competitive with other investment options available.

**1.11.2.3 Money Back Insurance**

Under this policy certain percentage of sum assured is returned to policy holder on regular interval. At the maturity the remaining amount is paid as the maturity amount. It is a savings plan with the added advantage of life cover and regular cash inflow.

**1.11.2.4 Children’s Plans**

Children’s plans are taken on life of parents for benefit of children. It ensures that, in case of death of the parents, the child gets the sum assured and the insurance company may fund future
premiums so that the child can get the value accumulated at the end of the term. Children’s plans are suitable for passing on a financial asset to a child.

1.11.2.5 Pension Plans

Pension Plans or annuities are Plans used for Retirement benefits. An individual can invest as a lump sum amount or periodical amount till age of retirement. Maturity amount can be taken as a monthly payment (annuity) from the accumulated funds. One can also withdraw one third of total accumulated amount once the person has retired. There are two types of Annuities: Immediate and Deferred. In Immediate Annuity Plan, one pays premium in Lump sum mode and retirement benefits starts soon after the retirement. In Deferred Annuity Policy, insurer regularly pays premiums to Insurance Company till the vesting age or date. Annuity starts after the age of retirement.

1.11.2.6 ULIP

It is a combination of investment and insurance. Corpus of ULIP is invested in a basket of market linked securities. The major advantages of market-linked plans are that they leave the asset allocation decision in the hands of investors themselves. They are in control of how to distribute the funds among the broad class of instruments. ULIPs are little expensive than pure term plans or endowment plans. There are charges like Premium Allocation charges, fund management charge, policy administration charge, and mortality charge etc. which are levied to insurers. One should consider their own risk appetite, tenure for investment before purchasing ULIP plan.

1.11.2.7 Term Insurance

Term insurance is an insurance product, which covers only risk there is no element of investment associated with it. It pays the sum assured only when the policy holder dies during the period for which is determined. Term insurance is the cheapest form of life insurance. Term life insurance provides for life insurance coverage for a specified term of years for a specified premium. If insurer survives the tenure then he receives nothing.

Different Types of Non-Life Insurance Products
1.11.2.8 Property

Insuring property means insurance of buildings, machinery, stocks etc. against risks to fire, theft etc. It covers the protection of building against natural and man-made disasters. Property insurance covers Fire Insurance, Burglary Insurance, and Marine Insurance etc. Things which are not covered in property insurance are wilful destruction of property, damage due to wear and tear and Art and antiques.

1.11.2.9 Health – Medi-claim policy

Health insurance / Medi-claim protect insurer and their family members against any financial contingency arising due to a medical emergency. This policy provides for reimbursement (Many policy have cashless options also these days) of hospitalisation/ domiciliary treatment expenses for illness/ disease or accidental injury. Medical expenses incurred during period of 30 days prior to and period of 60 days after hospitalisation are covered. Normal exclusions include all diseases/ injuries which are pre-existing at the time of taking the cover. There are many variants and riders available on simple health insurance plan. Facility like group health insurance and family floaters are also available, which cover the group of employees and all the family members respectively.

1.11.2.10 Motor Insurance

Under this Insurance, the company indemnifies the insured in the event of accident caused by or arising out of the use of the motor vehicle anywhere in India against all sums including claimant’s cost and expenses which the insured shall become legally liable to pay in respect of (i) death or bodily injury to any person, (ii) damage to the property other than property belonging to the insured or held in trust or custody or control of the insured. The insurance of motor vehicles against damage is not made compulsory but the insurance of third party liability arising out of the use of motor vehicles in public places is made compulsory.

1.11.3 Investment Planning

Investment Planning defines optimum asset allocation of funds based on risk appetite, financial objectives and time horizon of investor. Plethora of investment options are available today to
park surplus money. There are many different financial products available under different asset class; one should carefully choose the Financial Products so that they can achieve their financial goals within stipulated time. Things to be considered while choosing the investment products are discussed below:

**Returns generated by the product**
The Rate of return generated by the investment product can be in the form of capital gains, or regular cash flows, or both. A retired person may be more interested in regular cash flows to cater for his day to day needs, where as a younger person in accumulation phase may be more concerned with growth of his investment for creating a corpus for his retirement.

**Capital Protection**
Protecting the capital is the important criteria while selecting an investment avenue. Each investment avenue has risk and return associated with it. Risk and Return goes hand in hand. Higher the risk, more is the expected return. One must understand risk and return associated with any product before investing his money in any of the investment products.

**Inflation**
Inflation is the rise in general price levels of goods and services in an economy over a period of time. Inflation erodes purchasing power of money. The objective of investment is to get returns in order to increase the value of the money. Investment product should be able to beat inflation.

**Taxation**
Return generated from investment assets is liable to taxation. The real return from any investment product would be the return after taxation.

**Liquidity**
Liquidity is the ability to convert an investment product into cash quickly. The amount needed for any emergency should be invested in instruments having higher liquidity.

**Different Investment Avenues**
Investment Avenues can be classified as Financial Assets and Non- Financial Assets.

**Financial Assets**
Financial Assets can further be classified into Cash instruments, Equity Instruments and Debt Instruments.

**Cash Instruments**
Money in the Cash is the most Liquid asset available. But the cash in hand can’t generate any return so over a period of time because of inflation value of money can be eroded. One can keep money in cash form for the purpose of emergency expenses. On an average three to six months of our average monthly expenses should be kept in cash instruments.

Various cash instruments could be:
- i) Cash in Hand
- ii) Cash in Bank

**Debt Instruments**
Investing money in debt instrument is like one lends their money. One may get stipulated interest periodically on the capital invested. The capital is returned after the designated period. Capital is relatively protected than equity instruments; returns are normally lower than equity. Different debt instruments are: Small Saving Schemes, Government and Corporate Debt Securities, Bank Fixed Deposits.

**Small Saving Schemes can be further classified as:**
1. Public Provident Fund
2. National Savings Certificates
3. Post office Monthly Income Scheme
4. Senior Citizen Saving Scheme
5. Post Office term deposit
6. Post office savings Accounts
7. Post office recurring deposit
8. Kisan Vikas Patra
9. Sukanya Samriddhi Account

1.11.3.1 **Public Provident Fund (PPF)**
The PPF account can be opened in branches of State Bank of India, Some Nationalized banks and Post Offices. It can be opened by an individual for himself/herself, and or on behalf of a minor of whom he/she is a guardian. Tenure of the PPF is 15 years. One can invest minimum amount of Rs.500/- in the account maximum of Rs. 1, 50,000/-. One can invest a lump sum amount or can invest in instalments not exceeding 12 per year. Amount invested in PPF per year is eligible for deduction under sec 80C of Income tax Act 1961. The interest earned by PPF is completely tax free in hand of investors. Interest rate is notified by the Central Government in official gazette from time to time. Loan facility is also available on PPF. Though maturity period is of 15 Years, one can partially withdraw the amount from 7th year and every year thereafter. An account holder can withdraw 50% of his balance at the end of the 4th or the 1st previous financial year, whichever is lower. Main benefit of PPF is that it is not subject to attachment (seizure of the account by Court order) under any order or decree of a court. A person can have only one account in his name. Two accounts even at different places anywhere in India are not permitted.

1.11.3.2 National Saving Certificates

NSC has a Five year term with tax benefits under section 80-C of Income Tax Act, 1961. Minimum investment is Rs.500/- and there is no maximum limit for investment. It can be bought by an individual or jointly. NRI, HUF, Companies, trusts, societies, or any other institutions are not allowed to purchase the National Saving Certificates. Certificates can be used as collateral to get loan from banks. Current interest rate is 7.9% p.a. One can avail NSC from Post office.

1.11.3.3 Kisan Vikas Patra

One can invest minimum Rs.1000/- in KVP and it doesn’t have any maximum limit on investment. Amount will be matured in 113 months. Current Interest Rate on KVP is 7.6%. Tax will not be deducted at source and one can withdraw the amount after two and a half years of investment. It can be used as a collateral security for raising money. It can be purchased from any departmental Post office.
1.11.3.4 Senior Citizen Savings Scheme

Investor age of 60 years and above is eligible for the same. It has 5 years maturity period. NRIs and HUF are not eligible to invest in this scheme. Maximum limit on investment is Rs.15,00,000/- (Rupees fifteen Lac only). Any Post Office in India having the facility of savings bank account, or an office or banking company or institution authorized by Central Government, can operate this scheme. An investor can open more than one account subject to the condition, that amount in all accounts taken together does not at any point of time exceed Rs.15 Lac. The current interest rate is 8.4% p.a. payable quarterly. The benefit of section 80C is available on investment but interest is taxable at source.

1.11.3.5 Post Office Monthly Income Scheme (POMIS)

This scheme provides a regular monthly income to the depositors and has a term of 5 years. Minimum investment amount of investment is Rs.1500/- and maximum amount in case of single account is Rs.4,50,000/-, and in case of joint account is Rs.9,00,000/-. Current Interest rate is 7.6% p.a. payable monthly. Nomination facility is also available.

1.11.3.6 Post Office Time Deposits (POTD)

This is similar to FD of Banks. It can be opened at Post office by an individual. Any amount of account can be opened by any individual in any of the post office. It can be open for 1 Year, 2 Years, 3 Years and 5 Years. Investment in 5 Years TD qualifies for deduction under Section 80C of Income Tax Act’ 1961. Interest rates are calculated half yearly and withdrawals are permitted after six months. Accounts can be pledged as a security for availing a loan. Also nomination facility is available for this account.

1.11.3.7 Sukanya Samriddhi Account

It is a small deposit scheme, which can be opened in Post office. It has started in 2015 with the objective of accumulating fund for Girl Child for her marriage and education purpose. Amount invested in scheme is exempted under sec 80 C of Income Tax Act’1961. A legal / Natural guardian can open the account in name of the Girl Child. Account can be opened upto the Age
of 10 Years and mature at the age of 21 years. Minimum Investment amount is Rs 1000 per year and Maximum is Rs. 1,50,000 per year. Current rate of interest is 8.4% p.a.

The Government and Corporate Debt securities include Government Securities, Treasury Bills, Commercial Papers, Certificate of Deposits, Government Bonds, and Non-Convertible Debenture etc.

**Equity Instruments**

**1.11.3.8 Mutual Funds**

Mutual Fund is a financial intermediary, which mobilise money from investors to various avenues like equity, Bonds, G –Sec etc., in line with the investment objectives of the scheme. Through mutual funds, one can invest in different class of assets. The fund mobilized through Mutual Funds is handled by professional fund managers and they are parked in diversified assets. The investor gets units of full amount they have invested. There is much transparency in the process and no hidden charges. One can transfer their money from one scheme to another scheme also. And Mutual Fund units can be redeemed easily so it provides reasonable liquidity too.

Different types of Mutual Funds are described below:

**Money Market / Liquid Funds**

These categories of funds invest the corpus in Money Market instruments like T- Bills, Certificates of deposit, Commercial papers etc. As these instruments are highly liquid funds invested in MMMF, these can be redeemed at a very short notice. As money is invested in the debt instruments capital is safe and so returns are low. But returns can be higher than Savings Bank Account. These are suitable for investors looking to invest their short term surplus with an objective of high liquidity with high safety.

**Debt or Income Funds**

These schemes invest the money in fixed income generating debt securities, issued by different agencies like government, private companies, banks, financial institutions, and other entities
such as infrastructure companies/utilities. The main aim of these schemes is to generate regular income at a low risk. As compared to the Liquid funds, these debt funds have a higher risk of default by their borrowers and can generate higher return also. There are varieties of debt funds available. Like Gilt Fund, FMP etc.

**Gilt Funds**
These funds invest the corpus in G- Sec. As G – Sec is issued by GOI, there is no credit risk associated with the investments. But returns generated by G – Sec are low, so the returns of the Gilt Funds are also low. Interest Rate risk is associated with the funds. These funds are also known as Government Securities Funds or G-Sec Funds.

**Fixed Term Plans or Fixed Maturity Plans (FMPs)**
FMPs are similar to Bank FDs. They are close ended funds. FMPs have a defined maturity period; say 3 months, 6 months, 1 year, 3 years, etc. The maturity of the debt securities in which the fund is invested, and the maturity of the scheme are almost the same. Hence, when the scheme matures and money has to be returned to the investors, the fund does not have to sell the bonds in the market, but the bonds themselves mature and the fund gets maturity proceeds. The units of the FMPs are traded on stock exchange, so it provides liquidity to investors also. These funds are suitable for investors who don’t want to take much risk and know the time when they will need the money.

**Equity Funds**
These schemes invest almost 65% of their corpus in equity market. Depending upon the type of shares fund have selected, these funds can been classified as, Growth funds, Value funds, Large Cap funds, Mid Cap or Small Cap funds, Sector funds, Equity Diversified funds, Index funds. Certain equity diversified funds have tax benefit under section 80C of the Income-tax Act, 1961 and have a lock in period of three years. These are Equity Linked Savings Scheme (ELSS).

**Growth funds**
These funds invest in the money in growth stocks, which are stocks that are expected to earn above average returns.
**Value funds**

Value funds invest in value stocks. That is stocks are out of favour with most investors in the market and the market price is low compared to the value of the business. The value style managers generally hold the stocks for longer time horizon than their growth style counter parts.

**Large cap funds / Mid. cap funds / Small cap funds**

Fund investing in stocks of large companies are called Large Cap Funds and those investing in stocks of midsized and small sized companies are called Mid Cap and Small Cap Funds.

**Speciality / sector funds**

These schemes invest money in specific sectors or industry, e.g., Pharma Funds, FMCG Funds, Infrastructure Fund. High risk is associated with this kind of fund so these are suitable for aggressive investors.

**Diversified equity funds**

These funds invest in stocks from across the market irrespective of market capitalization, Industry or style. The fund manager chooses stocks from a wider selection. As it invests money in diversified sectors, it is less risky than sector funds.

**Index funds**

It invests the money in stocks which constitute the index. So fund managers don’t play that active role. They just replicate the index they have selected.

**Hybrid Funds**

They are combinations of equity and debt funds. They can be further classified as Balanced funds, Monthly Income Plans (MIP).

**Balanced funds**

As the name suggests balanced funds invest equally between equity and Debt securities. To get an advantage of the provisions of the prevailing tax laws, these funds invest more than 65% of their assets into equity and remaining in Debt securities.
Monthly Income Plans (MIPs)
This scheme invests majority in fixed income securities with marginal exposure to equity. The Debt securities provide stability to the portfolio and equity provides appreciation of capital over period of time. Normally 80% of the scheme AUM is invested in fixed income securities and the balance 20% in equity stocks.

Exchange Traded Funds (ETFs)
The units of these funds are traded on designated stock exchange. It combines features of open and closed mutual fund schemes, and trade like a single stock on stock exchange. Gold ETFs are very popular in India.

1.11.3.9 Equities
Investment in equity shares means becoming a shareholder in the particular company. One also gets the voting rights of his share in the company. Higher risk is associated with higher potential of returns. If company does well and makes profit, the investor is benefited as he is part owner of the profit. However, if the business goes in loss, the investor would lose capital proportionately. Returns from equities can be in the form of capital appreciation and/ or dividends. One can do all fundamental and technical analysis before investing into direct equities. One should analyse the market size, business of the company, its competitors, regulations etc.

1.11.3.10 Derivatives
Derivatives are contract between two or more parties, which derive their value form the underlying assets. Traders in the derivative segments are Hedgers, Speculators, and Arbitragers.

Hedging is basically protecting assets from losses. It is basically taking reverse position to protect the funds against any odds in the market. This may compensate for any losses in cash market from fall of the stock price.

Arbitraging is taking the advantage of difference in prices in different markets and earning the profits. Say stock price in spot market is lower than the futures price. One can buy the stock in
spot market and sell the same in futures markets and can generate profits. On the day of expiry, the prices converges. Stock may move in any direction but profit is booked.

**Speculation** is taking positions in futures markets based on the expectations regarding the price movements of the underlying assets without having a position in cash markets.

Various derivatives instruments in use are Forwards, Futures, Options and Swaps.

Forwards are tailor made contracts between two parties. They are not standardized contracts and hence they are not traded on exchange. Normally traders trading in currency market use forwards contracts to hedge against fluctuations of exchange rate.

Futures are standardized exchange traded contracts. Contracts are available for the period of 3 months, 6 months, 1 year etc. Last Thursday of every month is the expiry of every contract. Futures are available on single stock, Index and commodities. One needs to keep margin in the account for the trading purpose. Futures can be traded only in lots.

Options are categorized as Call Option and Put Option. Call option gives the buyer a right to buy the underlying security at a predetermined price in predetermined period. Call option gives the buyer a right to buy the shares/underlying asset at a price which is below the market price and vice versa for seller. Put Option gives the buyer a right to sell the underlying security at a predetermined price during a predetermined period. Put option gives the buyer the right to sell the shares/underlying asset at a price which is above the market price. Option buyer has to pay the price to the seller to buy this option, it is known as Option Premium.

**Non-Financial Assets**

1.11.3.11 Commodities

Commodities are the real physical assets like, agricultural products, precious metals like Gold, silver, oil etc. Futures and Options contracts on these products are traded on commodities
exchanges like, MCX and NCDEX in India. The working of the derivative contracts are discussed in the above segments.

1.11.3.12 Real Estate

The rapid rise in the price of the property in recent years, have made the real estate as one of the most lucrative investment avenue. The benefits of investing in real estate can be appreciation of capital, rental income, safety etc. Investment in Real estate can take following modes:

a) Residential Property.
b) Commercial property.
c) Industrial real estate
d) Agricultural land.
e) Semi urban land.
f) Time share in a holiday resort.

Residential Property
This investment provides return in the form of rental income and appreciation in capital. Tax shelters are available on interest paid and principal repayment, provided the investment is done through the route of a loan.

Commercial property
Buying a shop or office in a commercial complex may offer rental income and capital appreciation over a time period.

Agricultural land
Agricultural income from agricultural land is not taxable. Further, agricultural land is exempt from wealth tax too.
1.11.3.13 Other Non-Conventional Investment Avenues

Investments in Precious Metals, coins and other collectibles and Art objects are illiquid investments. They are the most risky investment avenues. As organized exchanges are not available for these instruments, one should be very careful while investing in these instruments.

1.11.4 Retirement Planning

Changing Family structure from Joint to Nuclear, increase in life expectancy and absence of robust Social Security system have increased the importance of Retirement Planning. Retirement Planning is determining how much amount will be required to fund the expenses during the retirement years and how that amount can be accumulated during the pre-retirement tenure. Ideally, one should start retirement planning with the starting of their first job. One can invest their money in employer initiated schemes like Employee Provident Fund (EPF), gratuity, superannuation, etc. Apart from that, there are other alternatives available like; PPF Account, NPS, Pension & Annuity Plans, and Reverse Mortgage etc. in which one can invest as a part of Retirement Planning.

According to CPFA- NISM (2012) there are two methods to calculate Retirement Corpus. They are Expense Protection method and Income Replacement Method. In Expense protection method, one lists down his/ her total monthly or annually expenses, then, those amounts are adjusted for inflation. Amount which then arrives, indicates the corpus required by person post retirement, which will be generating regular income equal to calculated expenses. Income Replacement Method calculates person’s income just before retirement.

Tools for Retirement Planning

1.11.4.1 Provident Fund

Provident Fund (PF) is the traditional and most popular product for Retirement Planning. A certain amount is deducted from employee’s salary every month and invested in Provident Fund by their employers. Provident fund is a debt instrument, pool generated by employees are invested in debt products. Employers also contribute their share in the employee’s account. On maturity investor gets total amount invested by him and his employer and interest earned on that.
1.11.4.2 National Pension System (NPS)

NPS is a Defined Contribution Scheme and it is regulated by PFRDA (Pension Fund Regulatory and Development Authority). The investment in NPS is to be maintained until the age of sixty. On retirement, a part of the corpus can be withdrawn as lump sum, and the balance would be paid as annuity. Government of India has started this scheme in 2004 for Government Employees. From 2009, it was made available to all citizens of age group 18 – 60 Years, except individuals who are covered under Provident Fund and Miscellaneous Provisions Act, 1952, Government employees who have joined services before Jan ’2004, Employees of Armed forces. It offers various investment options and choice of fund managers to their investors. Investors also have flexibility to switch over from one fund manager to another. Returns on this scheme are not definite; it is market linked product so return varies with performance of underlying assets. Amount invested under this scheme get exemption from income tax under Sec 80 C.

1.11.4.3 Reverse Mortgage

A reverse mortgage is a kind of Home loan. Any senior citizen having own house can avail it. Basically working of Reverse Mortgage is opposite to Home Loan. Loan Amount is divided in small monthly / quarterly / yearly instalments and paid to the lender by Bank. The loan is typically settled after the death of the owner/co-owners. Some additional features of NPS are discussed below:

1. The maximum tenure of the loan is 20 years.
2. Normally the owner of the property and spouse are borrowers in this scheme. If one of the borrowers dies then other may continue to avail the instalments.
3. The maximum monthly payments under the scheme is Rs.50, 000/-.
4. Settlement of loan after tenure will be done in two ways. If legal heirs settle the full amount of loan then property will be transferred to them, and if they don’t, then Bank will sell the house property mortgaged will settle the loan amount and if any amount is remaining then it will be passed on to legal heirs.
5. Facility of early repayment of loan is also available.

Normally senior citizens who don’t have steady inflow of income post retirement can opt for the same.
Apart from these schemes, plans discussed earlier like annuity, Pension Funds are also used for Retirement Planning purpose.

1.11.5 Estate Planning

The next stage in Personal Financial Planning is Estate Planning. Estate can be defined as all assets a person owns. Basic objective behind estate planning is to protect, preserve and manage one’s assets during and post one’s life. Estate of the estate owner should be passed on to estate owner’s intended beneficiaries. (C. Jayaram, 2007). For the purpose of Estate Planning, one can create their will or they can take route of trusts also.

1.11.5.1 Wills

It is a declaration made by a person clearly mentioning the manner in which one likes his or her property to be distributed after the death. It is a legal written document. It comes in power only after the death of the person. So till then it can be changed according to situation. As a part of Estate Planning, one should create their wills at early age only. This is to avoid any hardships to the family in case of death of the owner of the property.

1.11.5.2 Trusts

Trusts is a mechanism by which owner of property can pass the legal title of that property to another person to hold on trust for the benefit of the beneficiary. They are used as mechanisms to hold asset for present or /and future needs of legal heirs and other family members and designed in a manner to reduce the burden of tax. Trusts are used to accumulation of income and capital for specified children. Some terminologies related to trusts are discussed below.

**Grantor**

It is the person who creates the trust. One who is an owner of the property.

**Trustee**
This is the person or an institution that will follow wishes of grantor as per the legal document to manage the trust upon the death of the grantor.

**Beneficiaries**
They are persons who will be benefited by the trust property.
There are many financial institutions and Professionals, who work as a trustee for the fees.

### 1.12 Financial Planning Strategies based on Life Cycle Stage

Financial Planning of an individual depends upon his/her financial goals – short term & long term, number of dependants, stage of Lifecycle, risk appetite and many more. It is assumed that persons in the similar stage of life cycle have almost common financial goals. Life cycle of the individual can be divided in following four segments. Stage of the life cycle determines their future goals and risk taking capabilities. Depending on these factors, their financial planning strategy can be determined.

- **Young Unmarried Investor**
- **Young Couple with small children**
- **Mature Couple with grown up children**
- **Post Retirement Stage**

#### Young Unmarried Investor
Any one, who is young and single may have goal of wealth creation with long term investment horizon. He needs to give more importance on capital appreciation because he has to fund for all future responsibilities along with planning for healthy retirement. As the person is not married, he may not have much of the family responsibilities and his risk taking capability can be on peak at this stage. So one’s focus can be the pay-offs for any loans which he has and start investing aggressively into Equity and very small portion into fixed income asset class. If there are no dependants, then taking Insurance cannot be of paramount Importance. Also one can start investing into PPF, NPS, Annuity Plans or other Retirement Planning tool for Comfortable Retirement. It is advisable that one should start Retirement Planning from the first job itself.

- **Young Couple with small children**
Any one, who is married and has small children has long term focus and capital growth is of utmost importance for him. A person in this stage, may start thinking about buying his home. As the person has dependants on him, he may start taking good Life insurance policies, which may give protection to his dependants in case of any eventuality. One should take health insurance of own and family members. Investment should be done majorly into Blue Chip equity stocks which are not too volatile or they may take root of Mutual Funds to get advantage of diversification and Professional management, as also they can save tax by investing into ELSS. Contributions towards Fixed Income Securities should also be increased to balance their portfolio.

- **Mature Couple with grown up children**

A person in their mid-aged with grown up children have responsibilities towards higher education of their children or marriages. As their responsibilities are higher with years to retirement are less, they will have low risk appetite and objective will be maximum wealth creation before retirement. Portfolio should be revised in a manner to have exact balance between equity and fixed income securities. One can invest in balanced fund of Mutual Funds which is combination of Equity and Fixed Income Securities. Also as a part of Estate Planning, one can create a legal will or can create a trust to transfer the asset to their intended beneficiaries in event of death.

- **Post Retirement Stage**

In this stage, a person may not have a salaried income, at the same time, their children are independent and settled. His responsibility towards his children has decreased. One needs to have fixed flow of income to fund their routine household expense, healthcare expense and expenses towards leisure. Capital preservation with fixed flow of Income is their prime importance. A little holding in equity with higher exposure in fixed income securities like bond, Post office MIS, Post Office Senior Citizen Schemes are desirable. One can also take route of Reverse Mortgage for fund their post retirement expenses.
Every individual has different risk appetite and different goals, according to their own life conditions. Therefore, the strategy and asset allocation will change accordingly. One may take help of Certified Financial Planners and Advisors to create a balanced Financial Plan. After implementation of it, one should periodically review the same and make changes if it is necessary.

**TABLE 1.1 - Financial Planning Strategies Based on Life Cycle Stage**

<table>
<thead>
<tr>
<th>Stage of the Life Cycle</th>
<th>Age Group</th>
<th>Risk Capacity</th>
<th>Strategy Recommended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Young Single Investor</td>
<td>22 – 25 Years</td>
<td>Very High</td>
<td>Payoff the debt, Invest into Aggressive Equity Stocks, start planning for Retirement</td>
</tr>
<tr>
<td>Young Couple with small children</td>
<td>30 - 45 Years</td>
<td>High</td>
<td>Payoff the Debt, Take up Life Insurance Policy &amp; Mediclaim Policy, Investment into Blue chip stocks or Mutual Funds, Increase allocation in Fixed Income Securities.</td>
</tr>
<tr>
<td>Mature Couple with Grown up children</td>
<td>45 -58 Years</td>
<td>Medium to Low</td>
<td>Portfolio should be balanced of equity and fixed income security.</td>
</tr>
<tr>
<td>Post Retirement</td>
<td>58 Years &amp; Above</td>
<td>Very Low</td>
<td>A very little holding in equity with more investment in Debt Securities like, Post office MIS, Post office Senior citizen scheme, Govt. Bonds are desirable. Reverse Mortgage can also</td>
</tr>
</tbody>
</table>
be availed.

Source: Primary Data