Behavioral and Personal Finance
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Module – 02
Personal Finance
Lecture – 23
Personal Financial Goals

Hi, there welcome back to the course Behavioral and Personal Finance. In this course, we have so far discussed the first module on behavioral economics and finance theories and how those behavioral finance theories can influence our financial decision making. As we are progressing towards the second module of the course, that is focusing on the personal finance and decision making in personal finance context. We will discuss in the beginning, the basic theories or the basic concepts of personal finance and how these personal finance concepts can be related to the real money making decisions.

In this session, we will touch upon the basic concepts of personal finance and how Personal Finance Goals can be set keeping in mind the individual goals and objectives and certain other factors.

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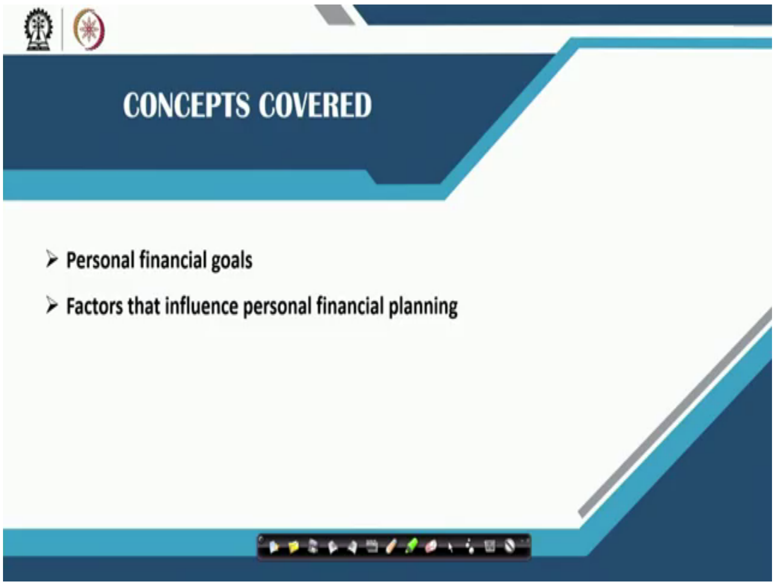

Two topics that we will touch upon in this session are how to set personal finance goals and how personal finance planning is designed. And we will also discuss in brief the factors that influence personal financial planning.

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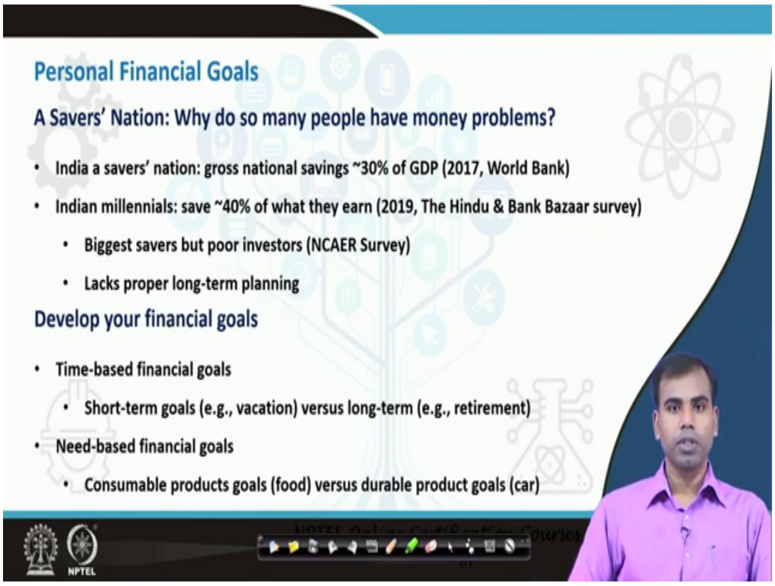

To begin with if, we want to start the discussion on how personal financial goals are set. Basically, we will try to understand why personal finance financial planning is important. As a nation India has always been the nation of the savers. If we look at the statistics, we understand that about 40 percent of the young millennials have savings in more than that they earn and they are one of the big savers in the world. If you look at the data, India stands in top 30 countries, where people save about 39 30 percent of the income that they earn.

Basically, in global ranking India stands in a list of savers nation, where people of the country save almost 30 percent of the GDP of the nation. It indicates that people in India have focused more on savings of their income. If you look at the recent survey done by NCAER which is National Council for Applied Economic Research in coordination with Max Life new insurance, we have seen that almost 60000 people who have been surveyed in this study, they save 40 percent of their income as investment.

However, they have not been able to save it say use their savings as proper investment because they lack financial planning. That is where, we can conclude or indicate that India is a savers nation; however, we are bad in financial planning and that is why most of us are always unhappy with our investment and financial planning decisions.

If we want to understand how financial planning goals can be set and designed in such a way that the savings that we accumulate over our earning life can be invested properly and used for securing financially beneficial future. There are two major types of financial goals, if we can try to categorize them. One being the time driven goals or time based financial goals and the second which is objective or need based financial goals.

If we understand time driven or time based financial goals, basically they are short term goals versus long term goals. For example, if we have to invest our savings in such a way that we should have sufficient amount of money on our short term goals such as vacation or entertainment or food. If we save our investment for long term basically we save the money that, we have earned and invest that money in long term goals for example, the retirement or education or maybe children's marriage.

If we categorize the financial goals in such a way that it is driven by the needs or the objectives, it could be consumption driven goals and can in particularly the consumption which are of short term which is consumable product goals and the other category could be the durable product goals.

If we are saving and saving and investing the money that we have earned for the goals such as food or other consumable products basically, these are consumable product driven goals and if we are saving our money in investment such that, we are trying to achieve goals of buying a car or a bigger house or any other such long term decisions they are durable product driven goals.

Basically, the process of designing financial planning it starts with the definition of the goals that we want to achieve. No planning can be successful unless the goals have been defined in advance. And then we will set up with the goals in order to achieve through the proper financial planning.

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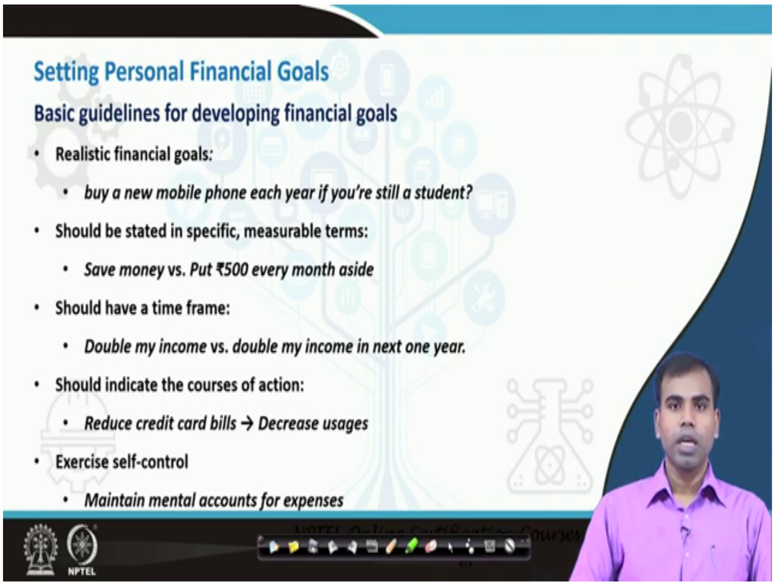

If we want to understand how the financial planning goals are set, we will have to understand what could be the possible areas or possible financial goals that we have to understand and implement. Basically, there are certain issues before we set financial planning goals and these issues could be taken care of well in advance. So, that the goals are achieved in a systematic way.

The first thing that is most important in setting up the financial goals is the goals should be realistic, when we are setting up our financial planning or we are trying to establish the financial goals that we want to achieve, we should make sure that these goals are realistic. For example, if I am a student and I want to set up a; set up a financial goal that I will buy a new mobile phone every year that is not realistic given that I am a student and I do not have a regular cash flow.

So, the goals that we are setting in terms of financial goals should be realistic enough to be achieved. Now, once we have set a goal which are realistic it should be stated in a very specific and measurable terms. For example, if we are saying that we would save money, this is not a more specific goal rather we should say that we will save 500 rupees every month as a student and this will accumulate over a period of our savings and create an asset.

So, the goals in terms of financial objectives should be defined in a very measurable and specific terms. Third issue that, we have to take care of is the timeframe. When we are setting the financial goal, that goals should be specified for a time frame to be achieved and when we are setting up the financial goal basically, the goal has to be achieved within a particular time and that is why it should have a specific time frame.

For example, if I say that my financial goal is to double my income, saying this much will not be sufficient because it does not have any specific measurable criteria or it does not have a specific time frame. So, if I say that I will double my income in next one year, then it meets both the criteria of specific measurable terms and timeframe for the achieving of the financial goal.

Next objective that we should keep in mind, when we design our financial goals, it that it should be indicating the course of action which implies that if we are setting up a financial goal, we should also keep in mind in a very explicit terms that how we are going to achieve the goal should be clearly defined.

For example, if I am a person using a credit card and I set up a financial goal that I will reduce my credit card bills, it should be specified in such a way that I should implement in an action plan that will suggest that I should reduce my expenses or credit card uses. Then only I should be able to reduce the credit card bills.

And finally, the most important issue is, to exercise self control. Even if we are able to define the financial goal, we have clearly indicated the measurable unit and specified the time frame along with the course of action that need to be taken to achieve the financial goal, if we fail to exercise self control, we should not be able to achieve the financial goal that we have started with.

So, first of all we should keep a mental account for all the expenses or incomes while we are setting up the financial goal and that is why where self control becomes very important. These are the issues that we have to keep in mind, when we are designing our financial planning goals

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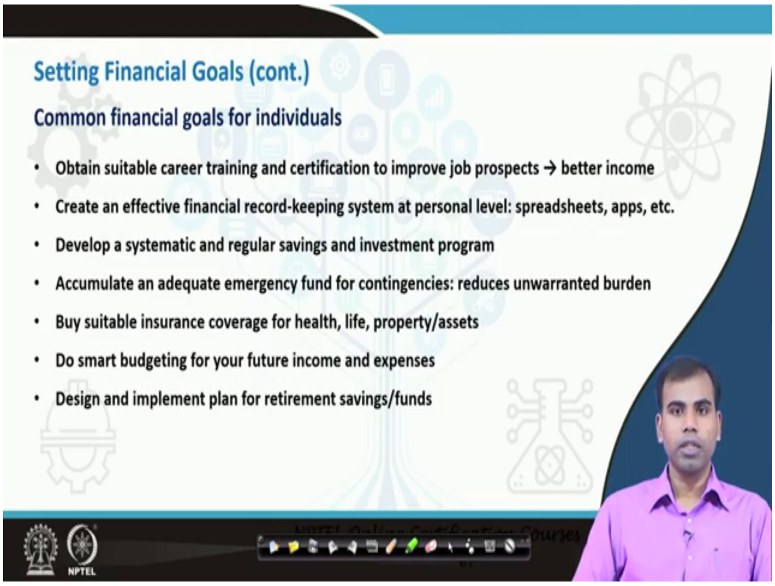

Moving further if we are setting up financial goals there are certain issues which we have to keep in mind along with the issues that we have discussed. There could be situations where they, we will design our financial goal keeping in mind certain objectives. For example, if we are trying to set up a financial goal that states that I will double my income in next one year; I should be clearly defining how we are going to achieve that financial goal.

So, in that process probably I would like to obtain a suitable career training or professional training or certification that will improve my job prospect. So, that my income will be increased and subsequently my savings will be increased and my investment will also be increased accordingly. And that then only I should be able to achieve the objective of doubling my income in next one year. There are certain other issues for example, if we have certain financial goals to achieve, we should also have an effective financial record keeping system at a personal level.

When, we talk about record keeping system basically, we indicate the bookkeeping mechanism of all the expenses and incomes. We believe that you must have heard of bookkeeping system in businesses, where business entities maintain records of all their transactions, where they maintain records in terms of trading and profit and loss account and balance sheet.

If you are familiar with these terms, you should be knowing that trading and profit and loss account of a company showcase the business transactions of economic values over a period of time and balance sheet of a company states the financial status of a company on a particular date or at a particular point of time.

So, if we contextualize this situation of bookkeeping to a personal level, it would be important for any individual to maintain a systematic record of all their incomes and expenses and assets and liabilities. Just like profit and loss account and balance sheet in a business. The good thing is there are a lot of technical tools and software's that are available for individual's health.

For example, you can use spreadsheet for keeping a record of all your transactions or all your incomes and losses and expenses. Similarly, there are several apps applications available on internet, where you can use your transactions for record keeping and making a systematic budget for the expenses and incomes of your financial planning.

Next issue that we have to keep in terms of common financial goal for people like us is to develop a systematic and regular savings and investment plan. When, we talk about common financial goals basically, it should be driven by a regular and systematic savings and investment plan.

For example, if a person is earning x amount of rupee a fraction of x amount should regularly be saved in such a way that it is available for investment in all possible avenues according to the preference of the individual. And this regular investment will over the years accumulate into a large chunk of investment that will create an asset for that particular individual. So, developing a systematic and regular savings and investment plan would help an individual to achieve the financial goals.

Next issue that is important is to accumulate an adequate emergency fund for contingencies. Basically, what it indicates is, if you are designing a personal financial plan. There should be adequate provision for emergencies which means if there are certain contingent situation, where you need some amount of money immediately for taking care of those situations. There should be a proper provisioning for those emergency situation and that can be achieved through a proper planning. It helps individuals to reduce the unwarranted burden that comes suddenly.

For example, expenses related to health hazards or some other unwarranted expenses that might come up come across suddenly. So, for individual to have a successful financial plan it is important to have an emergency fund to be saved aside. Along with these issues it is important for individuals to buy suitable and appropriate insurance coverage for health, life and properties.

Suppose, you are entering the job market and you are expecting that you will start earning money; you should have sufficient insurance coverage. So, that your contingent situation can be taken care of or if you have any dependent to take care of that situation can also be taken care of in case of an unwarranted situation. So, having insurance plan or insurance coverage for individuals and their family members will always support the financial planning in a positive way.

Another important issue that individuals should take care of is to encourage the smart budgeting for future income and expenses. What it implies is if you are trying to plan a financial goal and you have to make sure that, the financial goals are achieved in a successful way; you should have a proper budgeting for that particular purpose. When we talk about budgeting, it actually indicates that individuals should start estimating the expenses and the incomes that they are expecting in future and these incomes and expenses are incorporated in their decision making.

So, smart budgeting always helps in having a successful and achievable financial plan. And finally, having understood the process of financial planning and common financial goal for individuals, it should also be considering the design and implement implementation part of the retirement funds and savings that that might be required at a later stage of life. So, for individuals to have a successful financial planning, it is important to have a retirement savings or the financial planning for retirement. So, that the fund requirement or the monetary requirement at a later stage of life is well taken care off.

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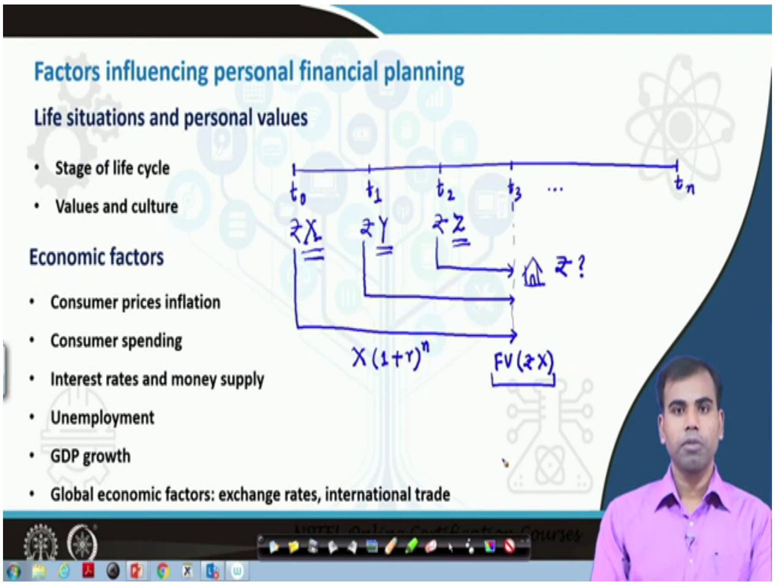

Subsequently, if we try to understand whether these financial goals are achievable or it has certain situations, where some other factors both in internal and external might influence the goals and financial planning of individuals, we should understand it from two different perspectives.

The factors that might influence your financial planning particularly in individual context are categorized into two broad divisions; first it is related to or it is influenced by the life situations and the value associated with the individual and second category is economic factors. So, when we are setting up a financial plan for an individual or we are designing a financial goal for individuals basically, it could be affected by the life situations and personal values.

Life situations such as the stage of life cycle might be an important factor to influence the financial planning of individuals. And on the other hand, the value and culture from which that person can is coming can also influence the financial planning and decision making related to financial goals.

We have already discussed in behavioral economics and finance module that individuals demographic characteristics and the value system and the culture to which the person belongs influence their understanding and decision making processes with respect to the financial decision making. Here also, we can relate to the fact that if an individual is in the early stage of life the person can take more risk and take decisions which are involving higher return with higher risk. Whereas, the individual being in a later stage of life, might be influenced by risk aversion and their decisions can be affected by the factors that might influence their life at a later stage.

Other set of factors that influence the personal financial goals are the economic factors. For example, if I am making a personal financial goal for myself it can be influenced by factors such as the inflation. Inflation as we all know is basically, the change in price or change in value of the currency because of the change in purchase purchasing power of that particular currency or we can also say in a simple term inflation is basically the reduction in value of the purchasing power of a currency or a economic unit of transaction.

So, when we say that the consumer price inflation or inflation in general affects the personal financial goal, we basically mean that if I have to set a financial goal of buying a house 10 years down the line. The value of the money that I am saving today can be different in future and that is why the amount that we are trying to save in the process or in the period that we are targeting for should be designed or should be estimated in such a way that it is it becomes adequate for buying the house 10 year down the line.

We have already learnt about the time value of money, where we have understood that if the cash flows or the money flow occurs at different points of time. Before we make a decision the cash flow should be brought at a common point of time and then compared with each other to understand whether the decision should be taken or not. If you could recall you would remember that in a situation, where the cash flow is on a time line I would repeat if the time line is designed in such a way that this is time line at a time 0, time 1, time 2, time 3 and so on. And time till n and I knew that I want to buy a house let us say 3 years down the line.

So, this is the time when I want to purchase a house in that case, I should start saving money right from here then here and then next period. And this money will be deposited in some investment or some savings instrument which will be available in future at time 3. Similarly, if this money is available at time 3 and this money is also available at time 3. So, going by the argument that we had discussed in previous module we know that if the amount of money is saved and invested is X, then we know that X has to be deposited or invested in an instrument wave, where we would get a return or rate of return r and the period for which we are investing that will be used for calculating the value at this point of time.

So, this is basically the future value of rupee X that we had invested in the beginning of the period. Similarly, for the next amount of money that we have saved in time one, this can also be brought to time 3, similarly for the amount of money that we have saved in time 2 will be brought to the time t 3 and all these money in terms of future value, we will be used to buy the house that we intend to purchase at point at this point of time.

So, when we talk about consumer inflation or the inflation in general, what we mean is that the value of money that we are saving today might not be sufficient to buy the house 3 years down the line. So, we should have a provision to adjust for this inflation which means the value the amount of money that we are saving in year 0, year 1 and year 2 these three amounts should be sufficiently estimated to cover the amount of money that we are going to need to buy the house at time 3.

Similarly, other factors in terms of economic inputs that might affect our personal financial goals are consumer spending which basically indicate that how much money are spent by consumers that also depends on several other factors such as interest rate and money supply. If we understand the basic economic arguments, we know that if the interest rates are changing that will change the money supply in the system in the economy of the country and that is where the consumer spending will also be affected.

In a very crude way, we can understand that if interest rate by banks are increased which means if you save the same amount of money in bank, if you deposit your savings in the bank, you will get higher rate of interest than the previous period. Then people will start saving more because they will save that money and deposit that money in the bank to earn higher rate of interest.

If the rate of interest is reduced by the banks, then the people who would want to save their money they would try to find some alternative and the money will not be deposited to that extent in banks rather they might would like to spend and that is where the money supply changes because of the interest rate and it also influences the consumer spending.

Other economic factor is unemployment which essentially translates into the purchasing power of individuals in the economy or in the market, where if people are employed gainfully employed they would be having purchasing power in terms of the money to spend on different goods and services and that is where their personal financial goals will also be affected.

Similarly, GDP growth has an influence on the purchasing power of the individuals living in that economy. There are other factors that might influence the financial goals or personal financial decision making such as global economic indicators. For example, foreign exchange rates, international trade and other similar factors which might be relevant for decision making in terms of personal financial goals.

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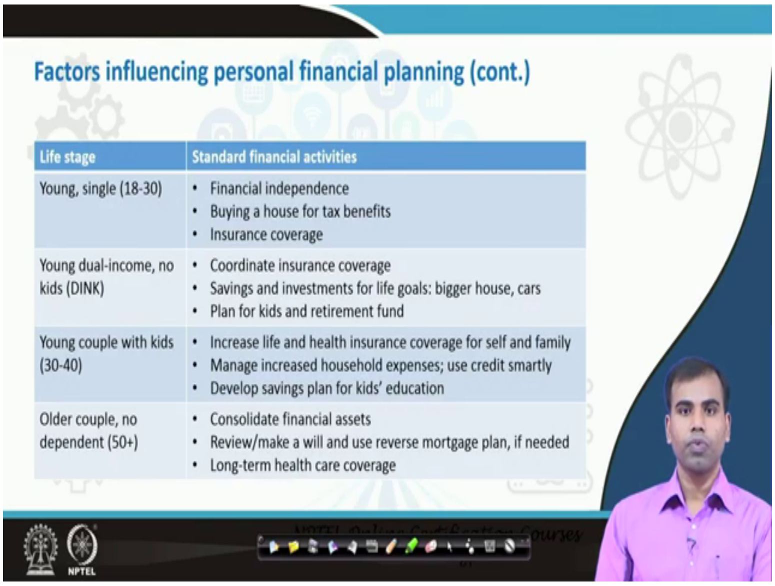

Having learnt these things, we know that these things can be translated to the factors specific to individual's needs and objectives. Here, we try to highlight four categories or four classes of personal financial goals, these four classes are for different people or people of different age groups. for example, the first situation or the first case is young individuals who are single or rather unmarried and they are in the age group of let us say 18 to 30.

So, personal financial goals for people of this age group or this category can be designed in such a way that it has some component of gaining financial independence and buying a house for tax benefits or other similar assets which will get them some tax benefits and tax advantage. And then also to get some insurance coverage for themselves.

If you talk about another category of people, let us say those who are young and married, but do not have any kids which is popularly known as DINK; double Dual Income No Kids, these people should focus in terms of financial goals on coordinating more insurance coverage for themselves and the family. Their savings and investments should also be directed towards achieving the life goals. For example they would want to have a bigger house for as the family grows, they should have a better car for a commute and similarly they should also plan for kids and their retirement funds in long run.

If you look at third category of individuals, let us say the people who are young couple and they have kids of teenage and the their age group might be 30 to 40. So, the financial goals that they should achieve should be directed towards having an increased life and health insurance coverage for themselves and family. They should also manage to increase the household expenses and they should try to use credit available for them in a very smart way. So, that the credit does not increase their liabilities in long run.

Another objective that they should keep in mind should be developing a savings plan for themselves and their kids in such a way that, when the kids grow their education and other requirement in terms of funding would be met from their savings. Another category that here that is highlighted here, is the older people those who are in their late 50s or early 50s and they do not have any dependent.

People of this age group should have their financial assets consolidated because they do not have any dependent. This would also make a will or if they have already made a will they should review the will and use the revenues and other savings that they have for their life saving life expenses and they may also consider having a reverse mortgage plan if needed. They should keep in mind the long term living expenses and health coverage for themselves and the family if they have.

So, here I try to highlight four cases of different age groups in terms of individual financial goals and these are some subtle indicators which individuals should keep in mind before designing the financial goals for personal finances. Although this list is not exhaustive and it totally depends on the category of the individual and their personal requirement and these things will be discussed in next session, when we will try to discuss more about how should we design personal financial planning and what are the processes that we should follow, when we design a personal financial goals. That is all for now.

Thank you.