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CHAPTER

Financial Goals and Planning

LEARNING OUTCOMES

The learning from this chapter will enable students

- get familiarized with the financial goals popular among the public
- understand how to prioritize and set financial goals
- learn the concept of financial planning and its need/importance
- become aware of the steps to follow in financial planning

INTRODUCTION

We can all agree that the ultimate goal of financial literacy is to attain the required skills to prepare a sound financial plan. We all have various goals which we want to achieve in life like funds for higher education, owning house property, owning a vehicle, children's marriage, retirement, etc. Without proper financial skills and knowledge, it is next to impossible to achieve all these goals. So, in this, we will look at the different types of financial goals and the steps needs to attain these goals.

FINANCIAL GOALS

Financial goals are the targets one intends to achieve through money management. Setting financial goals can help in attaining financial discipline. They assist in encouraging savings and making conscious investment decisions.

Some of the popular financial goals are given below:

◆ **Make a budget and live by it**: A certified financial planner and renowned author Ric Edelman once said "Budgets are focused on debts and expenses and nobody got rich by focusing on their debts," and "You get wealthy by focusing on your assets and your income." However, many experts agree that when it comes to financial planning budgeting has a lot to offer. They clearly define the amount of income and expenses of a household which helps in managing savings and investments.

◆ **Pay off credit card debt:** Being diligent in paying off credit card debt is very crucial. Credit cards are a great financial innovation but it is a bane as well if not managed properly. You never know, one default leads to another to another and after some time you realize are under a debt trap. In the words of Wohlwend, "Once you pay them off, you should be conscious about not using the credit card as much. The whole system enables people to make poor decisions. Once you get caught up in that culture, you don't even know what's happening until you add it all up".

◆ **Save an emergency fund:** 6 months' worth of expenses is a must. The job market is very fragile and you never know when medical bills might occur, emergency funds are essential.

◆ **Save for retirement:** Lusardi emphasised retirement saving by saying "We need to make a saving, particularly retirement saving as exciting as consumption. And it is exciting when you consider it gives us the capacity to reach our long-term dreams. People just need to see it that way''.

◆ **Live below your means:** This does not involve rocket science to understand. It is simple logic. If you spend more than you earn, you will incur debt and if your spending is within your earnings, you can save for your future.

◆ **Develop skills to improve your income:** Spending on oneself is very important and if those spendings are directed towards skill development is benefit is exponential. Thus, do keep targets on up skilling yourself and you will realize the world has a lot of opportunities to offer.

◆ **Save for your children's education:** The importance of college education can be realized from the fact that college graduates earn 66 per cent more than just high school graduates. The rising college tuition has mandated people to plan for their children's education well in advance.

◆ **Save a down payment for a home:** Owing a house property is a dream of every individual but the amount of investment it requires cannot be gathered overnight. Thus, one should start planning at the earliest. Remember, the greater the down payment, the more freedom and flexibility that's provided for the life of the loan.

◆ **Improve your credit score:** The credit score of an individual is like an assurance estimate of his/her creditworthiness. A person with a high credit score is eligible for loans at lower interest rates which is always helpful. So, the aim should be to maintain high creditworthiness.

As rightly said by Annamaria Lusardi, a George Washington University professor who also is one of the world's foremost experts on debt management "The bottom line is everyone can do more and everyone should do more to plan for their financial future,'' and "Make a plan, then follow that plan.''

HOW TO ACHIEVE YOUR FINANCIAL GOALS

Making a plan by prioritizing your goals is the most efficient way to reach financial goals.

When you analyse your goals, you will discover that some might take you some time to reach, while others do not so much. Thus, based on the time span, the financial goals are classified into 3 categories:

(A) Short-term Goals

Short-term goals are financial goals with a narrow scope and limited time horizon. It includes purchasing household electronics, furniture, house renovation, vacation spending etc. Moreover, the more important short-term goal is getting a grip on your spending, starting to practice budgeting, avoiding short-term debt defaults, setting a minimum limit of regular savings and starting building your emergency fund as soon as possible.

Short-term goals require you to question your spending and ask yourself "is it really that necessary?" If you are able to answer them honestly you are on the right path towards financial peace and freedom. This all might sound daunting to perform on your own but can always go to financial advisors for assistance.

(B) Mid-term Goals

The tendency to weight financial plans around the near and long-term goals has been called the "barbell" approach. However, due considerations need to be given to mid-term goals which take between 3 to 10 years to fulfil. Some examples of mid-term goals are a down payment on a house, paying off a study loan, international vacation, starting a business, etc.

As the time horizon increases, so does the money needed. Thus, an important mid-term goal is to generate multiple streams of income. In today's time where livelihood is getting expensive day by day, one cannot survive just with active income, you need to develop a passive income stream as well through part-time freelancing work or income-generating investments. Your financial counsellor can guide you towards your midterm strategy.

(C) Long-term Goals

Your long-term goals are directed towards being done with your responsibilities and lining a comfortable and stress-free life. Thus, some popular long-term goals are children's education, children's marriage and comfortable retirement. These goals are realised between 20 to 40 years. These goals require disciplined investing because they cannot be compromised.

The goal-setting process includes decisions regarding what goals you want to attain; determining the quantum of funds you need; and estimating the time period required to reach those goals.

ATTRIBUTES OF SOUND FINANCIAL GOALS: SMART

S stands for Specific

What do you want to achieve? One should start by answering this question. The goals should be clearly outlined and how they can be achieved must be clearly stated. This also helps in keeping oneself motivated to stay on the right track. Ambiguity about one's goals can lead to confusion and chaos and delays in achieving them.

For example, if you aim to save for higher education of children you must answer the following questions.

How much do I need for this goal?

How long do I have to collect the funds for this goal?

How am I going to collect funds for this goal?

M stands for Measurable

The essence of this attribute can be phrased as "if you can see it, you can do it". By measurable, we mean that one should be able to gauge his/her progress during the courses of fulfilment. This will help in keeping track of the current efforts and if any revisions are required in the efforts in the future. One can do so by putting small yearly milestones in the overall long-term goal to keep oneself in check.

For example, one can use a retirement calculator available online to gauge the process and see how much more is required to attain the goal.

A stands for Achievable

Wishful thinking can result in disappointment and mental distress. Financial goals are indeed challenging, but they should not be impossible to attain. One should be realistic about one's goals and should perform thorough research regarding their attainability.

For example, currently, you are 28 with an annual income of ₹ 7,50,000. You aim to retire at the age of 60 with a retirement corpus of ₹ 30,000,000. You have to ask yourself in light of current finances will you be able to achieve it or is it just wishful thinking?

R stands for Relevant

By relevance, we mean that your goals should not be arbitrary. They should be personal to you and must hold some significance to you. The path to achieving financial goals can be very tough and daunting and if you set a goal which does not hold any significance to you, the journey will feel like a burden and you will not enjoy it.

For example, when planning your retirement as yourself:

Will my family expenses in the future affect my goal?

Are there any activities or hobbies of mine which can deter me from attaining this goal?

How badly do I need to achieve it in the required time period? Can it be compromised or delayed?

T stands for Timely/Time-Bound

There are a few popular phrases like "You have all the time in the world" or "Life is too long to fret about things". They sound pretty nice and carefree. Right? But, being carefree can cost you your future. The timeliness of the financial goals ensures that you are serious about your goals and can set priorities. Thus, putting a time stamp on your goals is important. It also gives you a realistic deadline which can help is guiding the quantum of your efforts to achieve them. This can be done by giving oneself regular timely deadlines.

FINANCIAL PLANNING

Financial planning means developing a personal roadmap for your financial well-being. The outcome of the whole planning process is a path which needs to be followed to attain all the financial goals in the light of external hindrances like inflation, taxes, etc. It means systematically planning your finances in order to achieve your financial goals within the defined timeline.

Financial planning process

The financial planning process involves several steps that an individual can follow to achieve their financial goals.

Step 1: Define your financial goals

The first step in the financial planning process is to define your financial goals. This involves understanding your current financial situation and determining what you want to achieve in the short-term, medium-term, and long-term. Some common financial goals include saving for retirement, purchasing a home, paying off debt, and saving for a child's education.

Step 2: Assess your current financial situation

The next step is to assess your current financial situation. This involves reviewing your income, expenses, assets, and liabilities. By understanding your current financial situation, you can identify areas where you may need to make changes in order to reach your financial goals.

Step 3: Create a budget

Once you have a clear understanding of your financial situation, you can create a budget. A budget is a plan that outlines how you will allocate your income and expenses in order to meet your financial goals. It is important to track your spending and stick to your budget to achieve your financial goals.

Step 4: Develop a financial plan

After you have defined your financial goals and assessed your current financial situation, you can develop a financial plan. A financial plan is a roadmap that outlines the steps you need to take to achieve your financial goals. It should include a timeline for achieving each goal, as well as a strategy for how you will achieve them.

Step 5: Implement your financial plan

Once you have developed a financial plan, it is important to implement it. This may involve making changes to your spending habits, investing your savings, or making other financial decisions to help you reach your goals.

Step 6: Monitor and review your progress

It is important to regularly review and monitor your financial plan to ensure that you are on the right track to attain your financial goals. This may involve reviewing your budget, adjusting your financial plan as needed, and making any necessary changes to your financial strategy.

By following these steps, you can create a solid financial plan that will help you achieve all your crucial financial goals. It is important to be proactive and disciplined in managing your finances, as this will help you achieve financial stability and security in the long term.

Practical benefits to financial planning

Financial planning helps you to:

- **Increase your saving:** It is not impossible to save money without a financial plan will it be efficient that is something to be thought about. When you make a financial plan you become aware of your income and expenses which will help you in keeping track of them and assist in practising cost consciousness, which will automatically help you in increasing your savings in long run.
- **Enjoy a better standard of living:** It is assumed that high monthly bills and EMI repayments hinder your living standards. It is not true. A well-developed financial plan will help you to honour your obligations on time, meet all your expenses and still enjoy a comfortable and stress-free life.

- **Be prepared for emergencies:** The creation of an emergency/contingency fund is a must. It is the first step towards a stress and anxiety-free life. Unexpected financial distress can affect your mental health, which in turn affects your performance, which ultimately results in a loss of income stream. Thus, it is advised to maintain a fund equivalent to 6 months of your expenses.
- **Attain peace of mind:** A person practising financial planning is able to manage his/her finances properly and have a peaceful mind. Sometimes you might hit a rock bottom, but you should not be discouraged because ultimately you will reach your goal if you stay disciplined in the path of your goals. It might take you some time, but you will reach the stage of financial peace.

Need for financial planning

The financial plan serves as a guide as you go through life's journey. It helps you to manage your income, expenses, and investments in such a way that you can manage your finances and achieve your goals. You need to have enough money to achieve your goals and desires.

Personal finances can help us increase our cash flow. Keeping track of our expenses and usage patterns enables us to increase our revenue. Careful planning, careful spending, and careful saving ensure that we do not lose the money we have worked hard for.

A well-defined plan ensures that you do not deviate from them. It reduces the mental stress and anxiety related to financial well-being. If the goals are well defined in the planning process, one can customize the strategies in order to attain them.

We all agree that everyone thrives when appreciated for one achievement. As you attain your goals in your life, it will give you a sense of achievement which will further act as a motivator to stay motivated for future goals.

Personal finances include concepts related to money management, savings and investment. It includes banking, budgeting, debt, investment, insurance, retirement planning, and tax planning.

REVIEW QUESTIONS

1. What do you mean by financial goals? List out some of the commonly identified financial goals.
2. Explain different types of financial goals.
3. What are the attributes of a sound financial goal?

4. What is financial planning? Mention the steps in financial planning.
5. What is the need and benefits of financial planning?

PRACTICAL EXERCISE

1. After learning in detail about financial goals and financial planning, you were keen to share your knowledge with your elder brothers/sisters. While taking with you they disclosed that they never thought about developing a formal financial plan for their life goals. They asked you for your help. You are required to help them to analyze (using SMART) and set their financial goals and develop a well-structured financial plan. Document the whole process.