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# A Planned Approach to Financial Planning for Indian Investors - An Empirical Analysis

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## Abstract

*There has been a revolutionary change in the investment pattern of present day Indian investors. Conventional investors took investment decisions on the basis of their financial demographics, time frame of investment, and risk return trade off. However investors of present day are more educated and have complete knowledge of the various investment products as well adopt a strategic and planned approach to financial planning. The deregulation of the financial markets and facilitating financial policies and standards has also encouraged investors to follow a strategic approach to financial planning. Besides, the complex financial products and increased life expectancy of investors are necessitating investors to pay much more attention to diversification in allocation of, impact of economic and global conditions on the investment and timing of entry and exit of investments. The present study attempts to suggest a strategic approach to financial planning for Indian investors and bring to light the changing face of financial planning in India.*

**Keywords:** *Indian Investors, Financial Planning, Investments, Diversification, Lifecycle Stages.*

**Introduction:** Financial planning is an important element of financial decision. It is a route through which appropriate quantum of funds are available at the appropriate time in future to meet financial goals. An individual could have several goals which could range from buying a house property or planning a comfortable retirement or child's education and marriage. Since these goals are pertinent to an individual, these need to be achieved at the appropriate time in future. This requires every individual to plan accordingly so that these goals are met. Financial planning is the process of meeting an individual's life goals through the proper management of his finances.

Today, financial markets are becoming highly complex. Investors must be able to differentiate between a wide range of products, services and providers of financial products to successfully manage their personal financial requirements. Deregulation has also played an important role to encourage structural changes in the financial services industry such that there is an increased scope for entry of new players and expansion of existing players in an Indian Financial System. Therefore investors are aware that wealth creation is all about disciplined investment strategy, the key to which is appropriate asset allocation. The process of financial planning starts with identification of investment objectives of an individual. Each individual's financial objectives may vary in terms of goals, personal demographics, personal circumstances, and where in the life cycle the individual features. These objectives are classified into immediate, short term and long term. Investors are aware that these objectives will be realised not by pursuing the market trend but by designing and adhering to appropriate strategies over the period of investment.

As a general principle, it is advisable to devise one's objectives as unambiguously as possible. This is not really possible since their objectives do not remain static as a person's financial objectives changes as he moves through the life cycle and as circumstances change, hence there the financial objectives do not remain static.

## Literature Review:

Several studies have been conducted in the area of financial planning and importance of a planned approach toward investments. All these studies point out to an important factor of which is the foundation of financial planning in "Asset Allocation". A study by Brison, Hood and Beebower (1986) showed that over 90 % of variability in portfolio returns can be clarified by asset allocation. Friend and Blume (1975) observed that an individual's risk tolerance can be inferred from the asset allocation decision by calculating the percentage of a person's assets invested in the risky assets. The most important factor that influences the mix of assets that an individual should possess is the life factor. The assorted combinations of asset mix are always influenced by the risk tolerance level of an investor. Studies by Bajtelsmit et al. (1999), Reichenstein (1999), and Yuh, Hanna and Montalto (1999), have also illustrated that investors attitude towards risk is an important determinant of asset accumulation and retirement. There is also a perception that there is a relationship between financial literacy and financial planning. A study by Hussein A.Hassan, A. Tamimi and A. Anood Bin Kalli's, that showcased the financial literacy in UAE pointed out that the reality that although financial planning is on the high in UAE, yet the study finds that financial literacy of the UAE investors is below the required level. The study exhibited that

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financial literacy was an important factor that affected investment decision.

**Objectives of the Study:** The objective of the study is:

1. To understand the essence of financial planning.
2. To emphasize the importance of diversification in Asset Allocation process
3. To bring out the changing paradigm of Financial Planning.

**Statement of Research Problem:** Financial planning is inevitable in order to meet the financial goals of an individual. Financial planning is not about using different investment instruments or structures that we may be involved in investing presently. It is using the same instruments or investing options in a strategic manner so that desired or set financial goals are achieved. This goal oriented approach towards investment may ensure that the investor's have achieved their objectives at various stages of time without compromising on their present standard of living. Indian investors are not fully aware and convinced in the power and importance of financial planning to meet their financial goals and hence do not undertake financial planning but engage in abrupt investing.

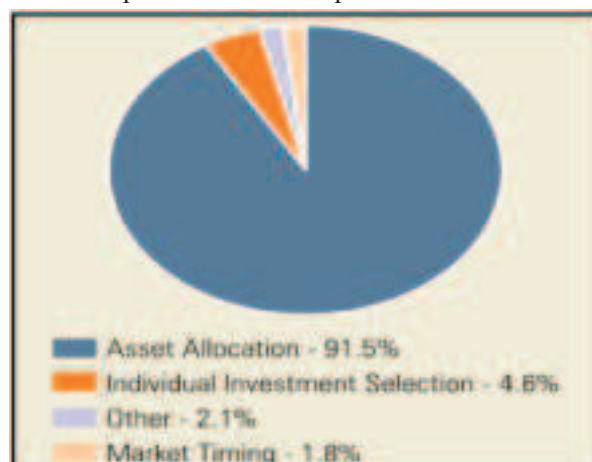
#### **Analysis and Findings:**

**Managing Risks through Diversification:** The foundation of financial planning lies in 'Assets Allocation'. Asset allocation includes combining various classes of assets in various defined proportions so that financial goals are met. This proportion of various assets in the portfolio is an important determinant of risk and return in the investment portfolio.

Every assets class has different characteristics and their reactions to changes in the market also differ amongst various asset classes. With complexities in the investing world and financial markets increasing, the concept of asset allocation has become an important pillar of sound financial planning. A well thought out asset allocation reduces the risk exposure of the portfolio whilst maximising the returns on the investments. Research studies show that approximately 92% of the portfolio's performance is dependent on the asset allocation decision. (Refer figure-1)

Investor's financial needs, length of investment horizon, risk taking appetite, personal circumstances, and personal demographics are important factors that affect the asset allocation decision. An important advantage of asset allocation is that it reduces the risk of an investment portfolio since it is based upon the underlying principle of diversification. This diversification by introducing various classes of assets reduces the impact of a single

asset on the performance of the portfolio.



**Figure-1 Portfolio performance indices**

Asset allocation decision is not a onetime decision, in fact it is a planned process. It takes into consideration the changing demographics of an investor and accordingly rebalances the portfolio by reviewing the investments within each asset class. Strategically, the portfolio should be diversified at two levels: between the asset class and within the asset categories.

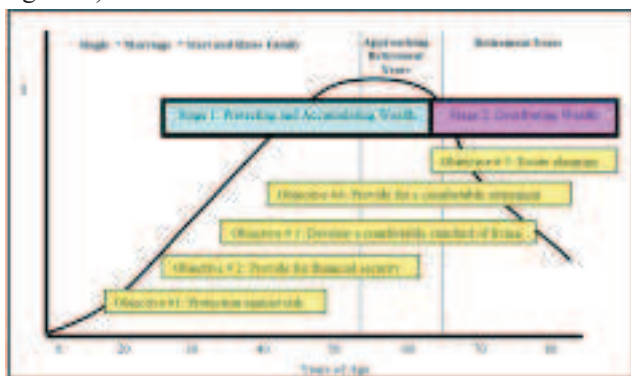
These asset allocation decisions are basically determined by the three ways: strategic distribution, dynamic distribution and tactical distribution. A strategic distribution includes a certain allocation, based on needs and preferences of an individual. A dynamic distribution is somewhere in the middle of both the approaches, where, the individual would broadly decide on the strategic distribution, but the allocation should be made keeping in mind the cyclical and structural changes in the market. A tactical distribution, takes the view that in a volatile interest rate whilst deciding the asset allocation.

#### **Essence of Life Cycle Stages and Financial Planning:**

The Asset allocation decision cannot be undertaken seamlessly unless the life cycle of the investors is analysed. Stage of the human life cycle of an investor is an important parameter while selecting the asset categories in an investment portfolio. As an investor passes through their life cycle their demographics change and these demographic variables play an important role while predicting the expected financial obligation like purchasing a house or making a provision for retirement.

Each of these life situations have their individual needs and financial objectives. There could be some contingency or event that might occur unexpectedly at any time that may be difficult to predict and such events are not really planned in the financial life cycle. Overall as an individual moves through his life cycle his objective and purpose of investment changes. The stages of life cycle play an important role to decide the strategy for

investment to achieve the specified objective.(Refer figure-2).



**Figure- 2 Life Cycle and Financial objective**

Source: *Life cycle of financial planning* by Gail M. Gordon, University of Wyoming Cooperative Extension Service, 2001

Each of these life stages of life cycle is has its unique financial objectives to fulfil, such as the call for protection of ones the family, amass wealth, distribute the wealth and provide for a timely return on the assets.

*The Changing Face of Financial Planning:*

With financial markets and financial instruments becoming more intricate, the need for accurate planning is also on the rise. This need has necessitated financial planning to develop new ideas. This has changed the face of financial planning and given it a fresh bouquet of financial instruments and theories and needs.

**Planning Retirement:** This aspect is not completely developed in a country like India. Planning for retirement means planning is to meet regular and routine expenses during the post retirement period without settling on the standard of living. This calls for through understanding of the social protection system of the country and employer sponsored retirement plans.

**Planning Legal Tax Payments:** This calls for planning an individual's tax obligation arising out of application of income tax a, wealth tax and other applicable laws in the country. It requires exact estimation of incomes and expenses of an individual and application of tax statutes that are applicable so that the impact of the burden of taxes in minimal whilst maximizing the returns.

**Planning a Continual and Uninterrupted Cash Flow:** This is a practice of allocation of funds in such a manner that there is an uninterrupted flow of cash to the individual, so as to meet the current expenditures whilst accumulating assets. This will also assist in future for meeting expected/planned financial goals and/or to meet unexpected expenses.

**Planning Risks:** This calls for using the advanced methods to minimise or mitigate the potential risks. It also involves an assessment of the individual's risk taking appetite and willingness to take risk.

**Planning Real Estate's:** This is a process of distribution of the wealth accumulated to the successors. The social factor plays a significant role during estate planning.

**Conclusion:** Financial Planning is an emerging concept the world over. In India, the concept of financial planning is still at a nascent stage. This is largely due to low financial literacy in our country and lack of sufficient financial knowledge. The journey has however begun and once we incorporate the concept of financial literacy in the education curriculum, automatically there would be emerge as an important standalone discipline. Indian investors must be trained to understand the power of financial planning to meet their financial goals so that they undertake investments in a planned manner and not abruptly. Whilst planning to meet their financial goals an investor must consider the various personal demographic, economic, social, legal and environmental factors so as to achieve their future financial goals. It is an important aspect to get prepared for the future, since

Stages	Objective	Requirement	Approach
I	Protection	Security against risk related to life , health and any other contingency	Initiating a contingency fund and insurance planning.
II	Financial Stability	Accomplishing family needs of quality education, standard of living and social life.	Sufficient financial security with apt credit and debt management
III	Standard of living	To have sufficient funds on retirement.	Retirement planning so that standard of living is maintained
IV	Financially self sufficient	Financial secured and have similar standard of living on retirement too.	The profits made in initial stages are generated.
V	Wealth distribution	To pass on the accumulated wealth to the successors.	Start planning for bigger goals like property and estates.

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decision made today would definitely affect the quality of life in future.

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