Voice of Money

Financial Blood Test Report

by *Mr. Sundar Sankaran*[1]

THE FINANCIAL PLANNING RITUAL

A 'financial road map' – listing of cash inflows and outflows – yearwise, going decades into posterity – is seen as a key deliverable by financial planners.

I have often wondered about the (f)utility of this whole exercise, which entails various assumptions – the inflation rate YEARWISE, yield on the investor's portfolio YEARWISE, growth in the investor's salary and expenses YEARWISE, the YEAR when the investor's daughter will get married, the YEARS in which the investor's children will go in for education and the expenses thereof etc.

While each of these assumptions is questionable, financial planners go through the ritual, religiously! I have seen them "manage" the assumptions to arrive at the desired result – for instance, by keeping the yield on the portfolio slightly above the inflation rate assumption. The neatly generated spread-sheets in MS Excel, project an aura of respectability to the report. Even the financial planner does not realise how much of it is "*spread-sheet-ing";* how much is *spreading shit!*

Rituals, imported from the developed world, are not suited for financial planning in India to become a mass exercise. Planners (Independent Financial Advisers and employees of banks and financial intermediaries), who are asked to perform these rituals, face multiple challenges:

- The challenge of making the economic and market-related assumptions
- The challenge of explaining these assumptions to investor-clients
- The MS Excel challenge of processing the yearwise financial roadmap from these various assumptions. (Compounding compounds their problems; discounting discounts their confidence!)
- The challenge of analysing the processed results to decide on a strategy for the investor-client
- The challenge of explaining the MS Excel report and the resulting strategy to investor-clients
- The challenge of finding time to do all this, for each investor, in a financially viable format.

The investor-client is equally challenged in providing inputs related to his own personal life – if you think you know when your 5-year old daughter will get married, read no further. This article is not for godly visionaries like you!

In a practical sense, you know your daughter's marriage may cost Rs15lakh, if it is held today. Let us say, your astrologer has told you the marriage will happen 6 years down the line. Your planner calculates that the inflation adjusted cost, 6 years down the line, is Rs25lakh. Neither the investor, nor the planner has a feel for the Rs25lakh number, because its purchasing power relates to a world that is yet to be experienced. Even if the planner makes a mistake in the formula and calculates it as Rs40lakh, most planners and investor-clients will not realise it, because of the lack of feel for the number - so much for the numbers, on the generation of which so much time is committed.

[1] Mr. Sundar Sankaran is Director, Advantage-India Consulting Pvt. Ltd and Finberry Academy Pvt. Ltd. He has also authored *Indian Mutual Funds Handbook* [Vision Books (2003, 2007)]. Sundar can be reached at sundar@advantage-india.in

Industry has responded to these challenges by providing financial tools, which resolve the planners' challenges of MS Excel proficiency and time for generating the report. They have made the ritual faster, but not questioned the need for the ritual itself. Most industries have understood the concept of GIGO – Garbage in, Garbage out. The financial planning industry is yet to internalise this.

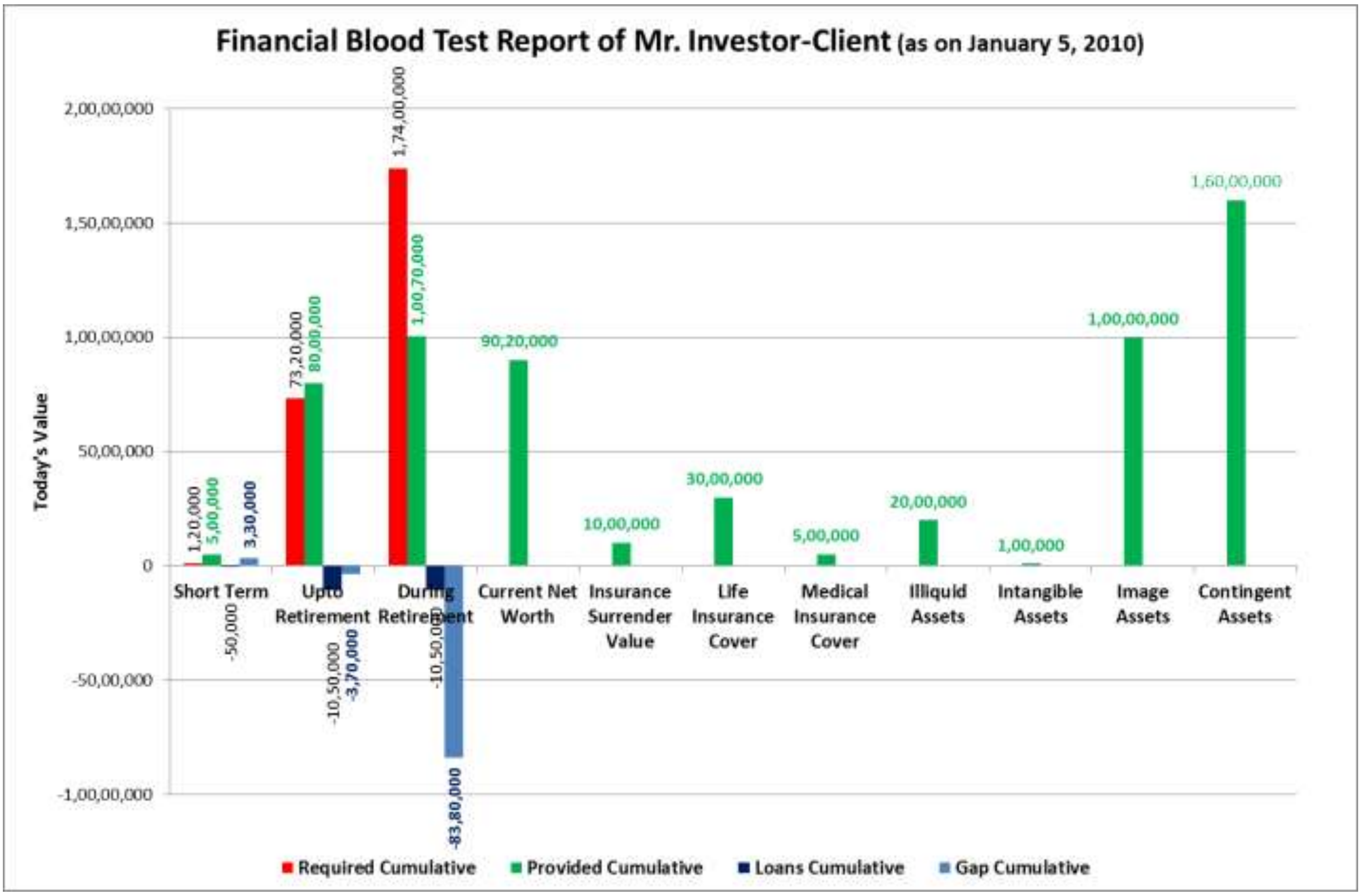
Financial tools have ensured that financial roadmaps are generated faster. Investor-clients trust the reliability of these roadmaps, as if they were the almanac. In reality, the roadmaps are misguided missiles. Planners, preside over the roadmaps, as if they are astrologers who can see the future.

You know the blood test. The doctor decides on the need for a blood test, based on reading of the patient's health. The pathology lab does the test and gives the results to the patient, who shows it to the doctor. Accordingly, the doctor advises on corrective steps, and the need for any further tests.

Unfortunately, financial planners are becoming pathologists – generating GIGO reports – when they ought to be performing the role of the doctor.

THE FINANCIAL BLOOD TEST REPORT

Just as flow of blood in the body is key to life, financial flow is key to a comfortable living. A Financial Blood Test report will look something like this.



Current Annual Income	**Rs12,00,000**
Savings Ratio	**35%**
Tax Ratio	**25%**
Asset Allocation:	
Equity in portfolio	20%

Speculative Component in Portfolio	15%
Market-linked Debt Assets in Debt Portfolio	30%
Fixed Return Asset Exposure in non-liquid Market-linked Debt Assets	45%
Illiquid Assets Distribution [Equity : Debt : Gold : Real Estate : Other]	10% : 0% : 0% : 90%
Expected dip in expenses on retirement	30%

As you will appreciate, your blood test report does not make projections of what your report will look like, yearwise into the future, given your life-style and environment.

The economy and financial markets are a lot less predictable than your life-style and environment. Therefore, in this framework, I have kept out all kinds of questionable projections / predictions of the future.

Benefits of the Financial Blood Test report:

- You can understand the profile of Mr. Investor-Client from his Financial Blood Test report. He is a middle-aged person, probably working in the organized sector. He has given importance to savings and investment.
- The Financial Blood Test report shows the current financial snapshot of the person, devoid of assumptions. (Yet, when you dwell deep into the framework, you will realize that the results are a lot more conservative than those suggested by the traditional financial roadmap.)
- There is a clear demarcation of what has already been saved, and what is likely to come in future.
- The Financial Blood Test report clearly categorizes assets, based on their liquidity, in both - the market and the mind. Asset allocation too has been X-rayed.
- The Financial Blood Test report tracks under-insurance / over-insurance.
- The Financial Blood Test report can be generated using paper and pen. No need for MS Excel or other financial tools. An adviser, who is not comfortable with addition and subtraction, might need to use a calculater (basic calculater – no need for a financial calculater).
- The proposed strategy glares back at you, without the need for any major analysis of the Financial Blood Test report. For instance, from the above Financial Blood Test report, it is clear that:
    - Mr. Investor-Client is reasonably comfortable, assuming a normal earning cycle upto retirement.
    - What would be a comfortable time frame for him to switch full time into spiritualism? About 6 years down the line.
    - Mr. Investor-Client can switch some of his contingency provisions (bank deposits, liquid funds) to better yielding assets.
    - Mr. Investor-Client appears to be under-insured.
    - There is scope to increase the equity exposure.
    - Debt portfolio can be risky in increasing interest rate scenario.
- The above results, and the strategy, are easily comprehensible by Mr. Investor-Client.
- The report can be easily compared across time, to check on progress / deterioration.

As with a normal blood test report, specific problem areas can be investigated further. If the above case does not relate to a middle-aged person in the organized sector, some of the data requires further investigation, which, in turn, might point to a different strategy.

CONCLUSION

The Financial Blood Test framework makes it easier for planners to render the service; and easier for investors to understand the report and resulting strategy. It can be offered by any planner in a financially viable format. Employees in banks can offer the service to a large number of clients. It is also possible for remote branches (which might suffer from weaker skill sets) to offer financial planning in the hinterland of the country.

Thus, financial planning can become a mass service – so critical, when the population mass has the money, but lacks the financial literacy.

Independent Financial Advisers often complain that they are not being paid for their financial planning service. They need to decide. Do they want to be pathologists or doctors?