ABC of Financial Freedom

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WHAT IS FINANCIAL FREEDOM?

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It’s always advisable to take the help of a qualified and experienced financial advisor for creating a roadmap for achieving Financial Freedom. This article is simplified with simple examples to explain the concept and give the overall idea about the process to be followed in brief. While doing it in real life there could be many more things that might need the attention. A qualified and experienced financial expert can help you in guiding you to achieve financial freedom at the earliest possible time, based on your current situation and requirement.

The Myth of Financial Freedom:

You might have read or heard a lot about Financial Planning or Financial Freedom planning. What does Financial Freedom Planning (FFP) mean? When can one claim that one is financially free? Many times we misunderstand “being Debt Free” as “Financial Freedom”. But it’s not true. Being debt free is just one aspect of achieving Financial Freedom. Being Debt free requires you to repay all your current liabilities like Home Loans, Auto Loans, and Personal loans while Achieving financial Freedom involves being free from working for money.

In one's life when a person is earning enough to cover his household expenses, insurance premiums, and EMIs, we believe that the person is enjoying financial freedom. While the fact is that, when a person requires working or putting in daily efforts to earn the required amount of money to fulfill all the commitments as mentioned above he/she cannot be said to have achieved financial freedom. So if you are into the job paying you a handsome salary or into the business giving you big profits which are enough to take care of all your expenses and pay for liability, you might feel that you are Financially Free. But it's the biggest "MYTH".

What is Financial Freedom?

How can one say whether is he financially free or not? It's very easy and simple. While you wake up in the morning from your bed, ask yourself, is it necessary to go for a job or do business to earn the money you need to survive and to pay for the debt? If your answer is YES, then you are not financially free. But if your answer is NO, then you are undoubtedly financially free.

When we say "Mr. X works for XYZ Ltd." who do you think is the employer and who is the employee? Obviously, Mr. X is an employee and works for his employer

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Mr. X is an employee and works for his employer which is XYZ Ltd. Similarly when we say “I work for Money” who is the master and who is the employee? In the given situation “I” is the employee working for the “Money” (employer). So unless in your life Money starts working for you, you can’t claim to be financially free.

Passion Vs Profession:

In the majority of cases, people often have to sacrifice their passion for their profession. Someone loving painting or photography or dancing is not into the profession of being a painter, photographer, or dancer. Some people are very much interested in doing social work or want to spend time doing some charity. But all of these people are not able to follow their dream and they work as a job man or businessmen in the area where they are not much passionate. Why? Because they are not financially free and that’s why their first priority by force is to “work for Money”.

Financial Freedom is the stage which if achieved will allow you to do all those things which you actually wanted to do. So financial freedom is not only about being free from work

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but is allowing yourself to do only those things which you love to do.

Simply putting you need to build enough Assets which can give you the regular cash flow for your recurring expenses and periodic requirement of cash for your future goals for a lifetime.

For example, if you need on average Rs. 600000 a year for your household and all other expenses. So you need to create an asset that gives you this required sum of Rs. 600000 to you in terms of interest or rent or royalty or dividend. So if, you build up a corpus of 1 cr and invest in the bank fixed deposit fetching you 6% per annum interest, then irrespective of whether you go on a job or do any business you will get the regular income.

Another example is you try and create a corpus that is enough to buy some property generating a rental income of Rs. 600000 for you.

In a nutshell, you need to create a mix of assets whether it is debt, equity, real estate, etc which can give you the required income of Rs. 600000 in total in the form of regular cash flow.

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For achieving financial freedom you need to first find out how much corpus you need to build to be able to generate the cash flow which can take care of your current and future requirements for household expenses and other financial goals. We can call that fund the Financial Freedom Fund. The amount of the Financial Freedom Fund would vary from person to person based on the different financial requirements of the person.

Mathematically, Financial Freedom Fund is the sum total of the present value of all the current and future expenses and EMIs you are supposed to pay till the lifetime. Seeking the help of a Professional Financial planner is advisable for finding out the required financial freedom fund for you. Once the Financial Freedom Fund is calculated, then you can adopt the most suitable investment strategy to achieve that targeted Financial Freedom Fund at the earliest. By doing a little bit of maths with the help of some financial advisor, you will get an idea about the time which is required to build the financial freedom fund.

There are 3 steps to achieve financial freedom at the earliest. It's called ABC of Financial Freedom.

01

ASSURING FINANCIAL FREEDOM

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Financial Freedom is not an individual goal or dream it's a dream for the family. This is the stage where in the absence of you, your family also enjoys the same financial freedom.

So before achieving Financial Freedom, it is very important that you assure the achievement of financial freedom irrespective of whether you are there or not. Assurance is the stage where an earning person ensures that even in case of the unfortunate demise of himself/herself, the family of his/her will get the Financial Freedom Fund.

As building the Financial Freedom Fund is a process that requires disciplined investment over a period of a few years, it requires man to work for money till the financial freedom fund is built up. Meanwhile one needs to protect and assure the achievement of financial freedom fund for the family against any unforeseen event like the unforeseen demise of the earning member.

Once the Financial freedom fund is calculated we need to find out the gap which is required to bridge between the Financial Freedom Fund and your current assets and investments. And whatever gap is

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need to be bridged by the Insurance to assuring financial freedom before it's achieved.

Financial Freedom Fund – your current assets – current life insurance sum assured

= Buy Term Plan

Let's take an example,

In this example to make it simple, I would ignore the inflation and time value of money for the sake of simplicity,

Mr. Prem is a family man having a wife and daughter in the family. Some of the data regarding his expense liability and investments are as below.

- *Monthly Household expenses:* ***Rs. 25000***
- *Amount needed for the higher education of Daughter:* **Rs.500000**
- *Amount needed for the marriage of Daughter:* ***Rs. 700000***
- *Current Outstanding Home Loan: Rs.120000*
- *Current total investment value: Rs.700000*
- *Life Insurance Sum Assured: Rs. 300000*

In the above case let's first of all let's find out the required Financial Freedom Fund.

Assuming an 8% risk-free rate of return, Mr. Prem needs around Rs. 37,50,000 for taking care of his household expenses. Rs. 37,50,000 if invested in FD then it would fetch Rs. 300000 as a yearly interest at an 8% rate of return which is around Rs. 25000 a month. So, the total financial freedom fund is the sum total of Rs. 37,50,000 plus the current and future liability. Once we find out the required amount of financial freedom fund we need to deduct the current value of Investments and existing sum assured from various insurance policies.

Rs. 37,50,000 (to take care of the household expense)
+ Rs. 12,00,000 (Outstanding Home Loan)
+ Rs. 5,00,000 (Daughter's Education)
+ Rs. 7,00,000 (Daughter's Marriage)

Rs. 61,50,000 (FINANCIAL FREEDOM FUND)

-Rs. 700000 (Investments)
-Rs. 300000 (Current Life Insurance)

Rs. 51,50,000 (GAP TO BE BRIDGED FOR ASSURING FINANCIAL FREEDOM)

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In the case of Mr. Prem, the Financial Freedom Fund requirement is Rs. 61,50,000 and the value of the investments and the current life insurance is 10 lacs. So there is a gap of Rs. 51,50,000 which he needs to build up through regular investments.

Mr. Prem needs to buy an additional life insurance policy giving the Sum Assured equal to Rs. 51,50,000. The best choice for assuring financial freedom through life insurance is to buy the Pure Risk cover also known as the Term Plan. As the term plan is the cheapest way to get the big risk coverage which is ideal in case of assuring financial freedom.

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BUILDING FINANCIAL FREEDOM

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Once you have been assured that your family would certainly get financial freedom even in your absence then we need to take the second and most important step. The step towards achieving financial freedom is Building the Financial Freedom Fund. The gap between the Financial Freedom Fund and the current value of your investment is the corpus required to be built up over a period of time through a wise investment strategy.

Continuing with the earlier example, the required Financial Freedom Fund was Rs. 61,50,000 for Mr. Prem, while the value of his current investments was Rs. 7,00,000. So in the case of Mr. Prem, we need to add Rs. 54,50,000 to his investment basket. The targeted corpus of Rs. 54,50000 lacs is to be achieved through various investments.

If Mr. Prem's monthly income is Rs. 45000 then he would leave with a surplus of around 16000 per month as the household expenses of Mr. Prem is Rs. 25000/- p.m. Assuming Rs. 4000/- p.m. is the premium he pays for the life insurance policies. Then he will be left with Rs. 16000/- p.m. and an existing investment of Rs 700000 as an investible surplus. Mr. Prem wants to get Financial Freedom in 17.66 years.

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Based on the above details, we need to find out how much rate of return is required on investment to generate the corpus of Rs. 54,50000 lacs by investing Rs. 16000/- p.m. in 12 years. The required rate of return, in this case, would be approx 13.68% CAGR (Compounded Annual Growth Rate).

If Mr. Prem opts to invest in postal recurring giving 8% CAGR return or any other instrument which gives a rate of return lesser than 13.68% CAGR, he would not be able to achieve his financial freedom in 15 years. It would take 16 years instead of desired 15 years to achieve financial freedom if investments fetch a return of 8%.

Selecting the right asset class based on the required rate of return is very important. A small mistake in opting for the wrong choice might lead to the wastage of some of the very important years of one's life in the slavery of Money, which otherwise could have been spent doing what one actually loves to do the most.

Instead, had Mr. Prem been able to generate the 15% CAGR on his investments, he would have achieved financial freedom in just around 11.43 years only.

The best way to build a financial freedom fund is by investing regularly through the SIP into the Diversified Equity Mutual Fund having a long track record. Investment into Mutual Funds through SIP is considered to be the most ideal way of creating wealth for any investor. It can generate better inflation-adjusted returns with much lesser risk.

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CASHING OUT FINANCIAL FREEDOM

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This is the final stage of achieving and enjoying financial freedom. At the beginning of this stage, the Financial Freedom Fund is already built through various investment strategies. One need to reallocate his Financial Freedom Fund into various investment from which he would get the required cash flow on a regular basis for one's needs.

In this stage of life, one needs to move out his money from the assets which are considered riskier and buy those assets which are less risky and can generate a stable income flow. One can look at the SWP (Systematic Withdrawal Plan) for the need for recurring expenses like household expenses, once the financial freedom is built. SWP gives the flexibility to choose the amount of monthly withdrawal according to one's needs.

Have you planned for your financial freedom? If the answer is NO, do it now. Remember, most people don't achieve financial freedom because they fail to plan rather than plan to fail.

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It is always advisable to consult a financial expert who can help you in creating a roadmap toward your financial freedom and also help you to stick to it in a disciplined manner.

"Financial Freedom is a mental, Emotional, and Educational process." Robert Kiyosaki

Happy Investing

Insurance is the subject matter of solicitation

Mutual Fund investments are subject to market risks.

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