

Personal Finance

Introduction to Personal Finance

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1.1 Definition

Personal Finance is the process of planning and managing your money to achieve personal economic satisfaction. It covers all financial activities an individual or household undertakes, from budgeting, saving, investing, insurance, retirement, to estate planning.

As per survey more than half of Indian don't know how to manage their finances, on 27% is financially literate, people know how to make money but doesn't know how to manage money. If one wish to live a stress-free life then they have to know and take charge to manage their personal finance.

Personal Finance is about building one's own relationship with money and how one can manage it. Every individual need and wants are different and unique and hence one plan will not fit all, therefore it is known as Personal Finance.

The approach to financial planning however stays the same with everyone. One can start personal finance by setting up clear goals, tracking the income and expenses, preparing a budget, building an emergency fund and investing based on the goals.

A personal finance plan can provide financial security, helps to prepare financial goal, prepares for emergencies, aid in enabling a comfortable retirement, thus brings peace of mind.

Personal finance is the management of an individual's money and resources in a way that ensures financial stability, growth, and long-term security. It covers everything from earning and spending to saving, investing, and planning for the future. For students, the study of personal finance is particularly important because it provides the knowledge and tools needed to make sound financial decisions throughout life.

Why It Matters

- Helps avoid excessive debt traps.
- Provides the ability to handle emergencies.
- Enables wealth creation step by step.
- Improves mental peace by reducing financial stress.

For example:

Ramesh earns ₹40,000 per month. Without financial planning, he spends most of his salary on rent, food delivery, shopping, and EMI for a new smartphone. At the end of the month, he has nothing left. One medical emergency in his family forces him to borrow money at high interest. If Ramesh had practiced budgeting and saved at least 20% of income (₹8,000/month), after 2 years, he would have built an emergency fund of nearly ₹2 lakh. This could have saved him from debt stress.

Thus, proper financial planning prevents crises tomorrow.

Key Dimensions of Personal Finance

1. Income Management

Income is the starting point of personal finance. It includes wages, salary, business revenue, investments returns, or allowances. Proper financial planning begins with understanding sources of income and creating strategies to increase it over time through education, career growth, or additional income streams.

2. Budgeting and Expense Planning

Budgeting is the process of creating a plan for spending money. It helps track income and expenses, ensuring that spending does not exceed earnings. A suggested rule to learn is the 50/30/20 rule:

- 50% of income for needs (rent, food, bills etc)
- 30% for wants (entertainment, shopping)
- 20% for savings and investments

Effective budgeting also develops discipline and prevents unnecessary debt.

3. Saving Habits

Saving money builds a cushion for emergencies and future goals. A strong financial plan involves setting aside funds in savings accounts or liquid instruments. The recommended practice is building an emergency fund equal to 3-6 months of living expenses. Developing savings habits early helps in achieving financial independence.

4. Investment Management

Investments help money grow over time by generating returns. Common investment options include stocks, bonds, mutual funds, fixed deposits, real estate, and gold. Students should understand the trade-off between risk and return and the importance of diversification. Time is a critical factor in investing, as compounding works best with early and consistent contributions.

5. Credit and Debt Management

Credit refers to borrowed money that must be repaid with interest. While credit cards, student loans, and personal loans can be useful, poor credit management leads to debt traps. Students should learn about credit scores, responsible borrowing, and timely repayment to maintain healthy financial credibility.

6. Tax Planning

Income taxation significantly impacts net earnings. Understanding tax laws, deductions, exemptions, and filing procedures helps individuals minimize liability legally. Students studying personal finance should know the basics of income tax, property tax, and GST to be financially responsible citizens.

7. Insurance and Risk Management

Life is uncertain, and insurance provides protection against financial loss due to events such as accidents, illness, or natural disasters. Common types of insurance include life insurance, health insurance, and property insurance. Adequate coverage ensures financial stability during difficult times.

8. Retirement and Long-term Planning

Even for students, understanding retirement planning is essential. Planning for retirement early allows wealth accumulation through pensions, provident funds, or retirement accounts. Due to compounding, even small investments made in youth can grow significantly over decades, ensuring a secure post-retirement life.

9. Financial Literacy and Decision Making

Financial literacy is the ability to understand and apply financial concepts in real life. It equips individuals to evaluate financial products, compare alternatives, and avoid scams. Developing critical thinking, risk assessment, and responsible decision-making skills forms the foundation of personal finance education.

Importances of Personal Finance:

1. Encourages responsible money management and prevents overspending.
2. Teaches the value of savings, investments, and long-term wealth creation.
3. Provides tools to handle loans and other financial obligations.
4. Builds habits of discipline, organization, and financial independence.
5. Ensures individual are better prepared for future financial milestones such as buying a home, starting a business, or retirement planning.

Personal finance is not just about money—it is about achieving financial freedom, security, and peace of mind. Understanding its dimensions gives individuals the ability to make informed choices, avoid financial pitfalls, and create wealth over time. For students, learning personal finance early develops lifelong skills that contribute to overall success and stability in both personal and professional life.

Scope of Personal Finance:

The scope of personal finance is vast because it deals with nearly all aspects of an individual's money-related decisions. It goes beyond just earning and spending; it covers planning, protecting, and growing wealth for a secure future.

Examples are-

1. Income and Cash Flow Management: Managing how money comes in and goes out of a person's life. It involves planning what to do with limited income to cover needs, wants, and future goals. For example: A student earning ₹10,000 from a part-time job prepares a monthly budget to allocate money for rent, food, mobile bills, and saves ₹2,000 for emergencies.

2. Savings and Emergency Planning: Building safety nets for unexpected expenses and future goals. Savings act as the foundation of financial stability. For example: A person sets aside 3-6 months' worth of living expenses in a savings account to deal with emergencies such as sudden job loss or hospital bills.

3. Investment and Wealth Creation: Making money grow through investments that generate returns over time. It also includes risk diversification and long-term wealth building. For example: A young professional invests ₹5,000 each month in a mutual fund SIP (Systematic Investment Plan). Over 20 years, the power of compounding significantly increases his wealth.

4. Credit and Debt Management: Responsible usage of borrowed money to avoid financial traps. It covers loans, credit cards, and repayment strategies. For example: A graduate takes an education loan to study abroad. By designing a repayment schedule based on expected future salary, they repay the loan without defaulting or harming their credit score.

5. Tax Planning: Minimizing tax liability through legal methods like deductions, exemptions, or investments in tax-saving schemes. For example: An employee invests in Public Provident Fund (PPF) and buys health insurance to avail tax benefits under Sections 80C and 80D of the Income Tax Act, reducing taxable income.

6. Insurance and Risk Protection: Protecting one's wealth, health, and family against unforeseen risks with insurance policies. For example: A working parent buys term life insurance so that in case of sudden death, their family continues to receive financial support for education, housing, and daily expenses.

7. Retirement Planning: Ensuring a steady income and financial independence after retirement through pensions, retirement funds, and investments. For example a professional invests in the National Pension Scheme (NPS) throughout their working life. On retirement, they access a corpus and pension income to cover expenses without depending on others.

8. Estate and Succession Planning: Planning how wealth and assets will be transferred to heirs in a smooth and legal manner. For example a person writes a will and sets up a trust for their children to prevent family disputes and ensure smooth property transfer after their death.

9. Financial Literacy and Knowledge Application: Understanding the financial system, products, and concepts to make better money decisions. For example: A student learns about cyber fraud and avoids sharing sensitive details online, thereby protecting themselves from digital theft or scams.

The scope of personal finance is wide-ranging and relevant at every stage of life. From managing student allowances to planning estates, each area prepares individuals for financial independence and stability. By practicing budgeting, saving, investing, and planning, individuals can secure their present as well as future financial well-being.

Objectives of Personal Financing:

The objectives of personal finance focus on helping individuals manage their money effectively to achieve financial stability, security, and growth. Each objective addresses a specific goal of financial decision-making and can be understood better with examples.

1. Ensuring Basic Needs and Financial Security : To make sure that income is sufficient to cover essential needs like food, housing, healthcare, and education.
Example: A college student creates a monthly budget to ensure that their stipend covers hostel fees, books, and meals without depending on additional loans.

2. Creating and Maintaining Savings: To build a financial cushion for emergencies and future goals through discipline and regular saving.
Example: An individual saves 20% of their monthly salary in a recurring deposit to build a fund that can be used during medical emergencies.

3. Wealth Creation through Investments: To grow money over time using various investment opportunities such as shares, bonds, real estate, or mutual funds.
Example: A young employee invests in equity mutual funds. Over 15 years, this multiplies his wealth and enables him to afford a new house.

4. Managing Risks and Uncertainties: To protect oneself and family from unforeseen risks through insurance and other protective measures.
Example: A family buys health insurance to ensure hospital expenses are covered in case of sudden illness without disturbing savings.

5. Tax Efficiency: To reduce tax burden legally by planning investments and expenses in a way that takes advantage of government tax benefits.
Example: An employee invests in Provident Fund, ELSS (Equity Linked Saving Scheme), and medical insurance to claim tax deductions under Section 80C & 80D.

6. Retirement and Future Planning: To ensure financial independence post-retirement by building a steady income stream even after active employment stops.
Example: A professor regularly contributes to the National Pension Scheme, ensuring he receives a pension after retirement to cover living costs.

7. Achieving Financial Independence: To free oneself from dependence on loans, debts, or others by managing income wisely.
Example: A graduate avoids unnecessary credit card loans and builds savings, so they don't have to depend on their family during unexpected expenses.

8. Meeting Life Goals and Aspirations: To plan effectively for major personal goals such as higher education, buying a house, or traveling.
Example: A couple invests in a long-term mutual fund with the objective of funding their child's overseas education in 10 years.

9. Estate and Wealth Transfer Planning: To ensure smooth inheritance or transfer of wealth, preventing disputes and safeguarding family interests.
Example: A businessman writes a will to distribute property equally among children, ensuring clarity in succession.

The objectives of personal finance revolve around balancing present needs with future goals. They aim to secure essential living standards today while building wealth and protection for tomorrow. By understanding and applying these objectives in daily life, students and professionals can achieve financial independence and long-term prosperity.

Some examples are

1. **Financial Security** – e.g., having an emergency fund saved Arun when he lost his job during COVID-19.
2. **Meeting Life Goals** – Amit and Neha saved via SIPs to fund their daughter's higher education abroad.
3. **Wealth Creation** – Raj started investing at 25, retired at 55 with ₹3 crore corpus, now lives off on passive income.
4. **Financial Independence** – Freedom from worry of EMIs or depending on children for old age.
5. **Peace of Mind and Happiness** – Not stressed about monthly bills, ability to pursue hobbies, health, and travel.

2. Basics of Personal Finance

2.1 Core Components

1. Income Management/ Sources of income:

- Identify sources: salary, business profits, rentals, dividends, freelancing, side hustles etc.
- Rule: Never depend entirely on a single source of income.

Example:

A teacher in Delhi earns ₹50,000 as salary. She also tutors students online part-time, earning an additional ₹12,000 every month. That extra income is invested in mutual funds SIP.

2. Expenditure Management (Budgeting)

- The key is separating *needs vs wants*.
- Budgeting rules:
 - **50/30/20 Rule:** 50% necessities, 30% wants, 20% savings & investments.
 - **Envelope Method:** Keep separate “envelopes” (now digital wallets) for categories like rent, groceries, entertainment.

Example:

An IT professional in Bengaluru earning ₹60,000 follows 50/30/20:

- Needs (Rent, groceries, utilities) – ₹30,000
- Wants (Movies, shopping, eating out) – ₹18,000
- Savings/Investments – ₹12,000

Within 10 years, just the ₹12,000 monthly SIP in mutual funds @12% CAGR can grow to nearly **₹28 lakh**.

3. Saving

- Build an **emergency fund** (3–6 months of expenses).
- Use high-interest savings accounts, recurring deposits, or short-term mutual funds.

Example:

Priya, a marketing executive, set aside ₹5,000 every month in an emergency savings fund. After 2 years, she accumulated about ₹1.25 lakh. When she lost her job during a company downsizing, this fund helped her survive for 4 months without borrowing money.

4. Investing

- The purpose of investing is to Grow money for beating inflation.
- Tools: Stocks, Mutual Funds, Bonds, Real Estate, Gold, NSC and more and more
- Rule: Start early + stay consistent = benefit from **compounding**.

Example:

If Ravi invests ₹5,000 per month in equity mutual funds for 25 years (at average 12% CAGR), he builds more than **₹95 lakh**. If he delays and starts at age 30 instead of 25, he ends with only ~₹53 lakh. “The cost of waiting = ₹42 lakh.”

5. Credit & Debt Management

- **Good Debt:** Education loan, reasonable home loan.
- **Bad Debt:** Credit card debt at 36–40% per annum, borrowing for luxury gadgets or vacations.

Example:

Ankit buys the latest iPhone worth ₹1.5 lakh using a credit card on EMI. Paying 24% interest, he will end up paying nearly ₹1.9 lakh in 3 years—extra ₹40,000 gone only in interest.

6. Insurance (Risk Management)

- Protects from financial shocks.
- Must-have insurance:
 - Term Life Insurance (10–15 lakh annual income).
 - Health Insurance (₹5–10 lakh minimum).
 - Life Insurance (Money back Policy etc)
 - Vehicle Insurance (mandatory).

Example:

Sunita, aged 32, took a health insurance plan of ₹8 lakh. Later, she faced a surgery costing ₹4.2 lakh. Insurance covered the hospital bills. Without insurance, she would have been forced to use savings or take loans. But with health insurance she paid nothing.

7. Retirement Planning

- Life expectancy is rising – retirement corpus is essential.
- Tools: NPS (National Pension Scheme), Mutual Fund SIPs, PPF, EPF.

Example:

If at age 30, Kiran invests ₹10,000/month till age 60 @10% CAGR → he accumulates ~₹2 crore.
If he delays till 40, investing for 20 years → only ₹76 lakh.

2.2 Golden Rules for personal finance are

1. Spend less than you earn.
2. Save at least 20% of income.
3. Avoid unnecessary debt.
4. Insure yourself adequately.

3. Spend Less to Save and Invest More

3.1 How to Spend Less (Practical Real-Life Examples)

Some Essential Strategies how to spend less are-

1. Create a budget and track expenses: Set a clear monthly budget, monitor every expense, and identify categories where money can be saved.

2. Cut out nonessentials: Reduce spending on dining out, entertainment, and impulse purchases. Focus on needs over wants.
3. Cancel unused subscriptions: Review all automatic charges and eliminate memberships and subscriptions not in active use.
4. Cook at home: Prepare meals at home instead of ordering out, which usually costs more. Planning weekly meals and shopping with a list helps avoid impulse buys.
5. Wait before buying: For nonessential items, pause for a few days to consider if the purchase is truly necessary.

Everyday Money-Saving Tips

1. Use public or shared transport: If possible, choose carpooling, public transport, biking, or walking.
2. Lower utility bills: Turn off lights and devices when not needed, and switch to energy-efficient appliances.
3. Shop discounts and second hand: Use discount codes, shop sales, and buy at thrift or consignment stores.
4. Review recurring charges: Regularly examine statements for unnecessary or duplicate expenses.

Building Sustainable Habits

1. Set goals and reward yourself: Make saving rewarding by aiming for concrete goals, like a trip or major purchase, and celebrate small milestones.
2. Automate savings: Direct a set amount to savings each month before spending elsewhere.
3. Unsubscribe from marketing: Reduce temptation by unsubscribing from promotion-heavy emails and apps.
4. Develop a habit of at least saving a penny.

3.2 Convert Savings into Investments. Example: If Rohan saves ₹7,500/month and invests for 20 years @12% CAGR → grows into **₹74 lakh**.

4. Financial Success & Happiness

The Real Meaning of Success: Having enough money for needs and goals, freedom from debt, and peace of mind. True happiness comes from financial freedom, not chasing luxury endlessly.

Example:

Two friends earn ₹80,000/month.

- Ajay spends everything on car EMIs, parties, travel loans → always stressed.
- Vijay saves/invests ₹25,000/month. Within 10 years, Vijay has over ₹50 lakh in assets. He takes vacations without loans and sleeps peacefully.

5. Practical Framework that an individual can Implement

1. Track Every Rupee. (Use apps/diary).
2. Build Emergency Fund = 6 months' expenses.
3. Buy adequate Term + Health Insurance.
4. Eliminate bad debt.
5. Start SIPs early (even ₹5,000/month compounds big).
6. Review goals annually.

Personal Finance is not about being stingy—it's about being **smart and intentional** with money. Spend on what gives long-term value, Save systematically, Invest intelligently, Insure for protection, Aim not just for wealth, but financial **freedom and happiness**.

Personal Finance Planning process:

1. Set Financial Goals: Define clear and specific financial goals with timeframes. Example: Instead of "I want to save money," say "I will save ₹20,000 per month for 12 months to make a down payment on a motorcycle." This makes the goal measurable and time-bound.

2. Gather Financial Information: Collect detailed data on income, monthly expenses, assets, liabilities, debts, savings, and investments. Example: Gather bank statements, bills, loan documents, and investment account summaries to know where money is coming from and going to.

3. Assess Current Financial Situation: Analyze your cash flow (income vs. expenses) and calculate net worth (assets minus liabilities). Example: If monthly income is ₹50,000 and expenses are ₹40,000, you have ₹10,000 surplus to save or invest. A positive net worth indicates good financial health.

4. Create a Budget and Plan: Prepare a budget allocating income towards necessities, discretionary spending, savings, and investments. A common method is the 50/30/20 rule: 50% needs, 30% wants, and 20% savings/investments. Example: For ₹50,000 income, allocate ₹25,000 for food/rent, ₹15,000 for entertainment/shopping, and ₹10,000 for savings and investments.

5. Build an Emergency Fund: Set aside 3-6 months of essential living expenses in liquid savings for unexpected events. Example: If monthly essential expenses are ₹20,000, build an emergency fund of ₹60,000 to ₹1,20,000 before making major investments.

6. Invest for the Future: Choose investments aligned with your goals and risk tolerance—like fixed deposits, mutual funds, or retirement plans. Example: Invest ₹5,000 monthly in a diversified mutual fund SIP for long-term wealth creation.

7. Implement the Plan: Start following the budget, saving regularly, managing debt, and investing as per the plan. Example: Automate monthly transfers to savings and investments accounts, avoid unnecessary debt.

8. Monitor and Review Regularly: Track progress monthly or quarterly, and adjust the plan based on changes in income, expenses, or goals. Example: If a salary increase occurs, increase the saving rate. Review investments yearly to adjust allocations.

This structured process helps manage personal finances effectively and achieve financial security over time

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