A Case Study on Effective Financial Planning in Malaysia

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Abstract

The pension fund is currently inadequate for most people. According to the Malaysian Financial Planning Council, financial independence is vital for Malaysians to accumulate sufficient wealth for retirement. This paper studies on how effective financial decision is important for long term retirement planning. A comprehensive financial data are obtained from a married working couple with children to evaluate their net worth, insurance needs, investment portfolio rebalancing, education planning and retirement planning. The results highlight that financial planning is essential to achieve financial independence, especially for insurance needs, education planning and retirement planning. The existing resources affect post-retirement lifestyle, medical funds and education funding. Suggestions are proposed to household to ensure that there is sufficient insurance coverage, lower all unnecessary expenses, re-structure of cash flow, and investment portfolios so as to rebalance in gaining greater wealth.

Keywords: Financial independence, retirement planning, net worth, insurance needs investment portfolios rebalancing

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Introduction

Malaysians are concerned about their financial resources during retirement as there is not much saving in their pension (Habib, 2007). Most of them depend on the savings from the Employees Provident Fund (EPF) which is a form of saving for retirement purpose (Dahlia *et al.,* 2012). According to Hunt (2009), 72% of Malaysians are ready to save their money for the purpose of retirement, however, 42% of them do not know how to prepare for their retirement fund. Most Malaysians are likely to depend on the interest derived from their fixed deposit and savings account. On the other hand, they divest their investment in unit trusts and shares to increase their wealth (Lusardi, 1999). This has caused Malaysian to have insufficient funds in their retirement plan.

It is important to deal with various financial products that require some knowledge about the products. It is vital to know about the financial information and skills to understand the various financial products offered in the financial market (Knowles,1975).The employees are obliged to plan, implement and evaluate their existing financial status and draw well-informed financial decisions (Kennickell *et al.,* 1997). Due consideration ought to be given to the issue of debt repayment, asset assessment, insurance needs, risk, investment portfolios and others (Bernheim, 1994). Unfortunately, not more than 5% of working couples are prepared for retirement (Habib, 2007) and are not confident due to financial illiteracy (Hunt, 2009).

In addition, for the educated working couple, they are capable to invest in shares and unit trusts. However, the return of those investments may still not be enough for retirement saving. Hence, the concern is pertaining to the investments that does not sustain long term retirement life. The possible reason could be the relatively low per capita income (HSBC, 2015).

Numerous research on retirement planning has been well-established in America (Hogarth, 2002), Australia (Beal and Delpachitra, 2002), Korea (Sohn, *et al.,* 2012), and UAE (Al-Tamimi and Al Anood, 2009). However, research on retirement planning is less investigated in countries that have low capita income, especially Malaysia. This paper studies a working couple on their financial decision for long term retirement planning.

The paper is arranged as follows. Section one discusses the past literature on financial planning. Section two describes briefly the methodology adopted in this study, including the financial background of the case study. Section three presented the results of the financial case. Section four discusses the findings of the case. Section five offers an insight into the implications of the study. Section six discusses the limitations and possible future research area of the study and provides a conclusion in section seven.

Literature review

According to DeVancy *et al.,* (1996), there are many practices for self-learning such as books, newspaper and magazines and friends, to obtain financial information. Financial knowledge is a necessary retirement preparation (Bernheim and Garrett, 2003).The gaining of financial knowledge enhances the decision-making in financial planning (Garman, 1998). Hence, working couple has more confidence about their retirement planning (Kim, *et al.,* 2005), so as it matches the retirement needs and financial resources.

According to Jacob-Lawson and Hershey, (2005), working couple must be capable to make judgments on the financial decision making, as it helps them to understand their retirement needs better. It shows that they have a good understanding of the fundamental financial planning, but insufficient knowledge on how to distribute the wealth (Dvorak and Hanley, 2010).

According to Delafrooz and Paim (2011), people are more active to participate in personal financial planning when the information is available. The concern is that they may not able to apply the financial knowledge to make judgment in financial decisions (Bayer, et al. 2009). Most of the time, people must show their capability to apply financial knowledge in life (Huston, 2010). Numerous research has focused on demographic factors of financial planning, and this includes gender, age, income, and others (Albeerdy and Gharleghil, 2015).Moreover, some research also studies on the role-play and its implication of financial planners (Hanna, 2011) and the impact on the education of the financial planning (Mandell and Klein, 2009).However, there is a need to increase the study on the application of unconventional media tool, such as computerized financial decision support system to prepare a comprehensive retirement planning.

According to Gao, et al. (2007), they use intelligent agent-assisted decision support system to study family financial planning, as such, Hunt (2009), argues that people are aware of the importance of managing effective personal finance. Therefore, a complex financial structure and regulation are required to be better managing in portfolio. According to Hunt (2009), he proposes the use of the computer-based system to offer financial-related advisory service to potential users. Gao, et al.,(2007) advocate that, the financial planning support system enables the user to constantly review financial situation and perform accurate decision making. It also can be done to update financial information regularly (Wen, Wang and Wang, 2005). In conclusion, this encourages working couple to be familiar with the financial planning support system (Wen, Wang and Wang, 2005) and serves as the method to promote the awareness of self-manage behavior in financial planning (Hira and Liobl, 2005). When they start to evaluate financial decision independently, working couple are keen to participate in the preparation of retirement plans (Barlett and Kotrlik, 1999), and it helps to develop necessary analytical skills in making financial decisions (Bernheim, 1994).

Methodology

This paper uses a case study to measure assets, liabilities, net worth and cash flow for a household. This provides an opportunity to evaluate the financial decisions on investment. All the financial

information is gathered by using a financial fact finding sheet. The respondents have been found to have some fundamental skills and financial knowledge as they have completed their tertiary education.
There are four important elements for the data collection. Section A is the background of respondents such as spouse and children, employment and existing health condition. Section B is the cash flow statement, which encompasses information on inheritance or borrowing, investment and purchase of assets. Section C is the summary of net worth statement of total cash assets, invested assets and personal-use assets and current liabilities and long-term liabilities. Section D is to set the financial goals and personal priorities of risk. The financial goals are divided into short-term, medium-term and long-term.

Financial background of respondent

The respondents John and May, aged 49 years old and 46 years old, are married for a few years with a child named Jeremy, 1-year-old. John holds a managerial post in a multi-national electronics and appliance company. Both of them are healthy without any medical problem. During the process of data collection, a qualified financial planner as a facilitator led them in the right direction. The facilitator also provides some suggestions to the respondents.

The pre-planning cash flow position for John is a total of net cash surplus RM40,212, for May with a shortage of RM612 due to unemployment after marriage. Hence, the total cash flow for both is RM39,600 surpluses. The total of pre-planning net worth position is

RM 536,044 which indicates both are capable to cover total liabilities RM290,956 from the total assets of RM 827,000.

Results

Several financial analysis such as financial ratio, total needs approach, portfolio rebalancing, education planning and retirement planning are performed to achieve the financial independence.

Financial Ratio Analysis

According to the results, liquidity ratio is 4.94 months and it highlights that respondents are only able to sustain their household expenses for less than five months if they are unemployed. Instead, they need to mobilize their emergency funding to sustain their living. The liquid assets to net worth ratio is 5.97% and it shows that the respondents have a shortage of liquid assets, such as savings and fixed deposits. The debt to asset ratio is 35.18% and it highlights that they are able to repay their debts through from the assets to prevent bankruptcy. In addition, the debt service ratio is 24.11% and it indicates that they have a financial capability to settle their debt repayment. The net investment assets to net worth ratio is 85.25% which shows a healthy financial status.

Total Needs Approach

For the next 20 years insurance needs, they are required to get protection in terms of family income replacement needs which is about RM511,522; medical & health insurance needs is about RM536,070; children's education funding needs is about

RM93,649.06; and debt cancellation funding needs is about RM84,956.

Components	Family incom replacement needs	Medical &health insurance needs	Children's education funding needs	Debt cancellation funding needs
Total Insurance Needed	941,522	536,070	93,649.06	84,956
Total Resources Available	430,000	0	0	0
Protection Gap	511,522	536,070	93,649.06	84,956

Table 1: Summary of insurance needs

Investment planning analysis

According to Table 6, respondents own RM457,000 fixed ringgit resources such as cash, fixed deposit, EPF, insurance cash value as the main financial and investment sources. They do not have sufficient savings for bonds and stocks investment. The portfolio does not distribute evenly based on industry benchmark on the ratios of fixed ringgit, 15%, income, 50% and equity 35%. The table below shows the before and after the restructuring.

Component	Description	Before		After	
		%	RM	%	RM
Fixed ringgit	Cash/fixed deposit/EPF/insurance cash value	100	457,000	15	68,550
Income	Bonds/REITs/property invested	0	0	50	194,225
Equity	Stocks/shares/unit trust	0	0	35	194,225

Table 2: Summary of Investment Planning

Education Planning

The respondents have sufficient educational funding for the children. The current three-year education fees are RM50,000, which equal to RM93,649.06 (refer to Table 7) for tertiary education at the age of 18 years old. In other words, they have to prepare another 16 years of saving for education fees. Therefore, the annual saving is RM4,291 yearly to support education fees.

Present value (RM)	Number of years	Interest	Future value (RM)
50,000	16	4%	93,649.06
Future value (RM)	Number of years	Interest	Yearly Saving (RM)
93,649.06	16	4%	4,291.00

Table 3: Education Planning

Retirement planning

With reference to Table 9, the respondents have an annual income of RM112,301 and RM3,200 for both at their first year of retirement. Both of them have to save RM182,926.50 and RM6,034.10 for retirement living in 10 to 13 years later.

The method of lump sum capital liquidation is used with the adjusted interest rate, 1.92%, the total lump sum needed is RM3,111,763.79. They have some liquidation resources such as savings, fixed deposit, life insurance cash value, EPF, property which equals to the total amount of RM1,921,996.46. However, there is a retirement gap of RM1,191,767.33 after considering the total lump sum need and resources.

Name	Present value (RM)	Number of years	Interest	first-year annual income (RM)
John	112,301	10	5	182,926.50
May	3,200	13	5	6,034.10
			Total	**188,960.60**
Name	**Payment**	**Number of years**	**Interest adjusted**	**Total lump sum need**
John	182,926.50	20	1.92	3,014,331.62
May	6,034.10	20	1.92	99,432.17
			Total	**3,113,763.79**
Resources	**Present value (RM)**	**Number of years**	**Interest**	**Future value (RM)**
Saving Account	15,000	0	20	15,000
Fixed Deposit	10,000	3.8	20	21,083.72
Life Insurance Cash Value	7000	4	20	15,337.86
EPF	425,000	5	20	1,127,651.52
Property 1	280,000	5	20	742,923.36
			Total	**1,921,996.46**
Retirement gap	**FV**	**N**	**I**	**PV**
Lump sum	1,191,767.33	20	6	371,598.70

Table 4: Retirement Planning

Conclusion

The results of this case study show that financial planning is essential to achieve financial independence. Working adults are urged to plan their retirement early to prevent huge gaps between financial resources and financial needs.The case study highlight to accumulate sufficient wealth through stocks and bonds investment, to cover monthly expenses. In terms of this, it is important to improve liquidity performance by saving cash in financial institutions, and repaying car loans to avoid high-interest bearing.

In addition, insurance needs, education funding and retirement funding are the most significant financial needs for everyone. The case study also reveals to have adequate insurance coverage for family income replacement need, medical needs for the next 20 years. They support the children’s tertiary education by allocating RM4,291 yearly in educational funding and are obliged to have sufficient funds to enjoy a debt-free retirement life.

The net worth value for respondents enables them to plan better for their retirement life, as the pre-financial status of RM2,512,310 is improved as compared to the post-financial status of RM1,921,996. The incremental value indicates the proposed restructuring plan is workable when managing the wealth accumulation. They have to start saving early to narrow the retirement gap. The total amount of saving required, which was inclusive of lump sum and annual savings, after 20 years is RM371,598.70 and RM1,191,767.33 respectively.

Implications

This case study presents on how working adults make financial decisions for retirement planning with the existing financial resources. The results show that the respondents do plan for the insurance, education and retirement. However, they have an insufficient fund to accommodate all their needs. It also implies that half a million net worth of financial resources is insufficient to sustain after retirement life.

From a practical perspective, working adults are advised to plan their financial resources to cater the financial needs. Results from the case offered several suggestions to avoid the pitfalls of financial dilemmas, such as the reduction of unnecessary expenses, re-allocate of cash flow, adequate insurance coverage and re-balance the investment portfolios to accumulate wealth.

This case study concludes that people are urged to obtain financial independence. They have to effectively distribute their financial resources to generate higher wealth. It shows that with half a million net worth is no longer sufficient to sustain people's wealth accumulation after retirement. Hence, there is a need to promote the importance of financial planning among working adults in Malaysia.

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