Indian Institute of Management Kozhikode

Case Study

IIMK/CS/133/FIN/2020/13

March 2020

Generating Sustainable Cash Flows during Retired Life: A Comprehensive Retirement Plan

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Mr. Ranjan is working as a IT project head with a MNC. He is 40 year old and completed his B.Tech from one of the reputed engineering colleges from India. He has also completed MS in Computer Engineering from a reputed US university. He has a working experience of close to 18 years in various IT domains. He is well placed in his job. On the family side, he is married with two kids. His wife Rema is a home maker. Ranjan is earning very well and currently his take home salary is 30 lakh per annum. He has been very particular about his saving right from the start of his career. He invested in two houses worth Rs 1 crore each. He stays in one house and given the other house on a rent of Rs 30000 per month. He has also taken a 20 year old hosing loan of Rs 50 lakh each for both the houses. His combined EMI for both the houses is around Rs 1 lakh per month. He also has a car EMI(Equated Monthly Instalment) of Rs Rs 10000 per month. Apart from real estate, he invests in Gold ETFs and Fixed deposits. He started investing in mutual funds in 2006 through SIPs. But he stopped the SIPs in 2008 when he lost almost 60% of his invested money. He never touched stock market after that. He has a medical insurance and a term insurance worth 1.5 crores. Ranjan developed the habit of reading investment books of late. He got fascinated by the concept of power of compounding, cost of capital, inflation etc. After reading multiple books, he became worried about his investments in fixed deposits since after tax returns from fixed deposits are below inflation. He is also much worried about his investments in second house as there are better apartments available for lower price. Moreover his rental yield is very low when you look at other investment options.

Recently, Ranjan met his college mate Mr. Jagan, in a marriage function, who runs a wealth management firm in the city. Ranjan shared his concerns with Jagan. Jagan assured to help him out. They met one week later in Jagan's office. Jagan convinced him about the fallouts of investing excessively on real estate, gold and fixed deposit. To his surprise, Jagan observed that Ranjan has a fixed deposit worth Rs 10 lakh in a low rated fixed deposit with a retail chain where the interest rate is 10.5%. On checking,Jagan found out that his happened as a result of Ranjan's pursuit of getting higher rate of return. Jagan explained to Ranjan on the need of parking a part of his savings in equity market through stocks or ETFs. But Ranjan was adamant on his stand on not investing in market. Jagan gave Ranjan some material to read which explains the long term performance of Indian stock market. They decided to meet after two weeks.

They met after two weeks. Ranjan changed his mind partially. He said that he will liquidate his investments in gold for Children's education, marriage etc. His Provident Fund will take care of retirement needs partially. He has agreed to invest in equity to create a fund for meeting his monthly expenses during retirement. He estimated it to be Rs 50000 per month in current money value terms. He would like to retire at the age of 60. He is expected to live till 85 year looking at his family history. Ranjan told that he will never invest in low graded fixed deposit again. Fortunately, his existing deposit with the retail chain is due to mature in two weeks time. What led to this quick decision? A quote that he read in the material shared by Jagan. It reads like this "Return of money is more important than return on money". Ranjan requested Jagan to create an equity portfolio to take care of his monthly expenses during his retirement. Jagan agreed to help. Ranjan asked the following questions to Jagan?

1) How much corpus will be created in a pessimistic, normal and optimistic scenario of returns?
2) What is the inflation adjusted monthly expense requirement at the time of requirement and during the retirement period?
3) How much monthly contribution(EMIs) is required to generate that corpus under pessimistic, normal and optimistic scenario of returns and inflations?
4) Is it possible to create an automated system under various regimes of returns and inflation(with some flexibility on pre-retirement and post retirement saving period)?

Ranjan made it clear that he can invest in equity only till retirement. After that he will shift to the corpus to an annuity that offers fixed rate of return. Jagan

Please help Jagan in preparing a comprehensive retirement plan for Jagan to meet his post retirement