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Basics of Retirement Planning - Importance of Saving for Retirement

Retirement is often idealised; it is visualized as a time when people are free to do what they want and pursue their life as they desire. However, the truth is that without the financial independence to do so, you will be leading a limited lifestyle. The private sector in India mostly does not provide pensions to employees and since the vast majority of the country works in the private or unorganised sector, it is up to the individual to carry out retirement planning.

What is retirement planning and how to carry it out?

Retirement planning is the process of determining your financial requirements during your golden years. It involves identifying a retirement corpus that can support a pension for the rest of your natural life post retirement. Here are the steps involved in retirement planning:

Identifying your retirement needs: Depending on the kind of lifestyle and your monthly expenses post retirement, you need to figure out how much monthly income you will need during retirement (usually around 60-80% of your current monthly income). However, a better method may be to determine your retirement expenses annually and arrive at a figure for retirement. As an example, a 30-year-old with current monthly expenses at Rs. 40,000 will need Rs. 32,000 per month in today's value (80% of current monthly expenses). If he plans to retire at 60 years and expects to live till age 85, his annual expenses in the first year of retirement will be Rs. 29.23 lakh or Rs. 2.43 lakh per month. He will need to build a corpus of Rs. 4.93 crore to generate that level of monthly income for meeting his expenses.

Calculate the gap: The more time you have during retirement, the higher will be the amount you need for your expenses during your golden years. This is due to the impact of inflation. As an example, Rohit, 28, plans to retire by age 60 with life expectancy of 85. Suhas, 28, plans to retire by age 60 with life expectancy of 70. Both have current monthly expenses of Rs. 35,000. Considering inflation rate of 6% and annual investment return of 12%, Rohit will need to accumulate a corpus of Rs. 2.81 crore for 25 years of his retirement period while Suhas will need to accumulate a corpus of Rs. 1.82 crore for 10 years of his retirement period.

Parameters you must consider for retirement planning: In order to determine how much you need to save for your retirement, you need to keep in mind the following elements:

Age of retirement and life expectancy: You need to decide at what age you plan to retire and consider the number of non-working years. The longer the period of retirement, the more funds you will need.
Rate of return: You need to assess how much investment return you can expect during your working years and how much during your retirement years (since you will need to reduce the amount of risk you can take with your investments, your investment returns will be lower during retirement).

Plan for life goals before retirement: You must avoid having to use your retirement funds for life goals such as marriage or education of children. Make sure you have provided for these goals to avoid using your retirement funds.

Calculate your retirement investment

Using a retirement calculator, you can calculate how much money you will require to retire. A retirement calculator works out the sum based on your retirement age, your current age, the assumed rate of return on your investments, your current expenses and the expected inflation rate. The amount of corpus that it computes is the fund that you will need to accumulate for your retirement.

Generally speaking, you should multiply your future annual expenses during retirement by 30, to get this amount. For example, if you need Rs. 12 lakh as annual expenses post retirement, the corpus you need to generate would be Rs. 12 lakh x 30 = Rs. 3.6 crore. In order to generate such a high amount, consider investing in equity-oriented mutual funds because they provide equity-linked inflation beating returns, which are ideal for retirement corpus building.

In order to pick the right mutual fund for your retirement, you should consult an investment professional such as a financial advisor or a mutual fund distributor who can sit down with you and help in retirement planning.