# LEARNER GUIDE

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| Unit Standard Title: | **Describe the financial life cycle of an individual and how this influences financial decisions** |
| Unit Standard No: | **230077** |
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# Describe the financial life cycle of an individual and how this influences financial decisions

## Introduction

The best saving and investing habits pay off throughout life. Yet, with age, it is probable that an individual's specific financial goals are likely to change. "Life cycle" planning identifies both common goals and investment strategies for the key stages of adult life. This knowledge can help financial planners when examining and reassessing their client's particular portfolio requirements.

In this module, we will look at the following:

- The wants and basic needs of an individual at different stages in his/her life cycle.
- The dynamic nature of income and expenditure typical at different stages of an individual's life.
- The interrelationship between an individual's basic needs and wants and the implications for a financial plan.
- Critical events that trigger entry into a new stage in the financial life cycle

## Module 1

# Analyse the needs and wants of an individual at different stages in his/her life cycle

This Module deals with:

- Theories relating to needs and the life cycle of an individual to create a model that illustrates the wants and the basic needs of an individual at different stages in his/her life cycle
- The effect of attitudes and values on an individual's perception of wants and basic needs
- The attitudes and values of at least three individuals surveyed and applied to the model and deviations from the model
- The influence of an individual's occupation and avocations, and lifestyle on basic needs and wants

How much should an average South African family save for retirement and the children’s education, and how much insurance should they buy for health care, disability, long-term care, and other contingencies?

Most financial planners today believe that the life-cycle model developed by economists over the last fifty years provides guidance for making such decisions. The theory teaches us to view financial assets as vehicles for transferring resources across different times and outcomes over the life cycle, and that perspective allows households and planners to think about their decisions in a logical and rigorous way.

Because our lives and goals are so different, there is no turn-key solution for managing finances and meeting financial goals. Successful people have identified several steps in planning for and meeting their financial goals.

We call these steps "Life Cycle Planning" because each step can be tied to the achievement of certain life defining events that almost everyone goes through.

## 1.1 Theories relating to needs and the life cycle of an individual to create a model that illustrates the wants and the basic needs of an individual at different stages in his/her life cycle

### 1.1.1 Categories

Life cycle planning often puts individuals into four or more broad age categories. While different names are used to describe each stage, and the number of stages differs, they generally fall into one of the following categories:

- Early earning period
- Later earning period
- Peak earning period
- Retirement

Note that one cannot allocate specific ages to these four categories – they are broad categories that could differ from individual to individual. We will introduce you to different models that illustrate different stages with different ages, but all these models provide for the above mentioned categories.

#### 1.1.1.1. Early earning period

During the first stage, individuals generally have low earnings and high expenses. Many professionals today pursue education until their late 20's or early 30's, at which time they begin their careers and earning. Those who pursue less education are usually entering their profession at a relatively low level of earnings.

At this time, portfolios tend to be small and more heavily invested for long-term growth. Individuals also tend to have high expenditures during this stage as they establish a first home, purchase a vehicle, pay off student loans, and possibly travel.

#### 1.1.1.2. Later earning period

The second stage, or later earning period, includes an increase in earnings and is characterized by high expenses as children are raised. The trend toward starting families later means that many individuals will have large expenses later in life, which may reduce the ability to save during this period.

#### 1.1.1.3. Peak earning period

The third stage encompasses the peak earning years prior to retirement. In addition, for many families higher expenses in raising a family are in the past. The focus can therefore shift to saving, investing, and debt elimination.

At this time, a slight reduction in risk and investment time horizon is often prudent, although most experts recommend a significant growth component to the investment portfolio. However, many individuals may have aging parents or university age children to support, so this stage may be marked by both high earnings and high expenses.

#### 1.1.1.4. Retirement

At retirement, focus usually shifts to preservation of capital and maintenance of lifestyle. Expenses are expected to be lower during retirement, but discretionary funds for travel and hobbies, is also often a goal. Careful financial planning is still necessary for the investor at the retirement stage. It is in this stage that many retired individuals may decide to gift their assets.

"A gift, in the law of property, is the voluntary transfer of property from one person (the donor or grantor) to another (the donee or grantee) without full valuable consideration. In order for a gift to be legally effective, the donor must have intended to give the gift to the donee (*donative intent*), and the gift must actually be delivered to and accepted by the done". *Source: Wikipedia*

Those who have built family businesses or substantial assets may find it more reassuring to gift assets during their lifetime when the process can be controlled, rather than leaving them as part of an estate.

### 1.1.2 Different Models

There are different models of the financial life cycle. If you do some research you will find many examples, however, each of them works on and uses the same principles.

We will now look at three different examples that illustrate the stages of life – from the simplest to the most advanced.

#### 1.1.2.1 The Traditional Family Life Cycle

This model indicates four stages in life, but does not illustrate the wants and needs.

EARLY EARNING PERIOD

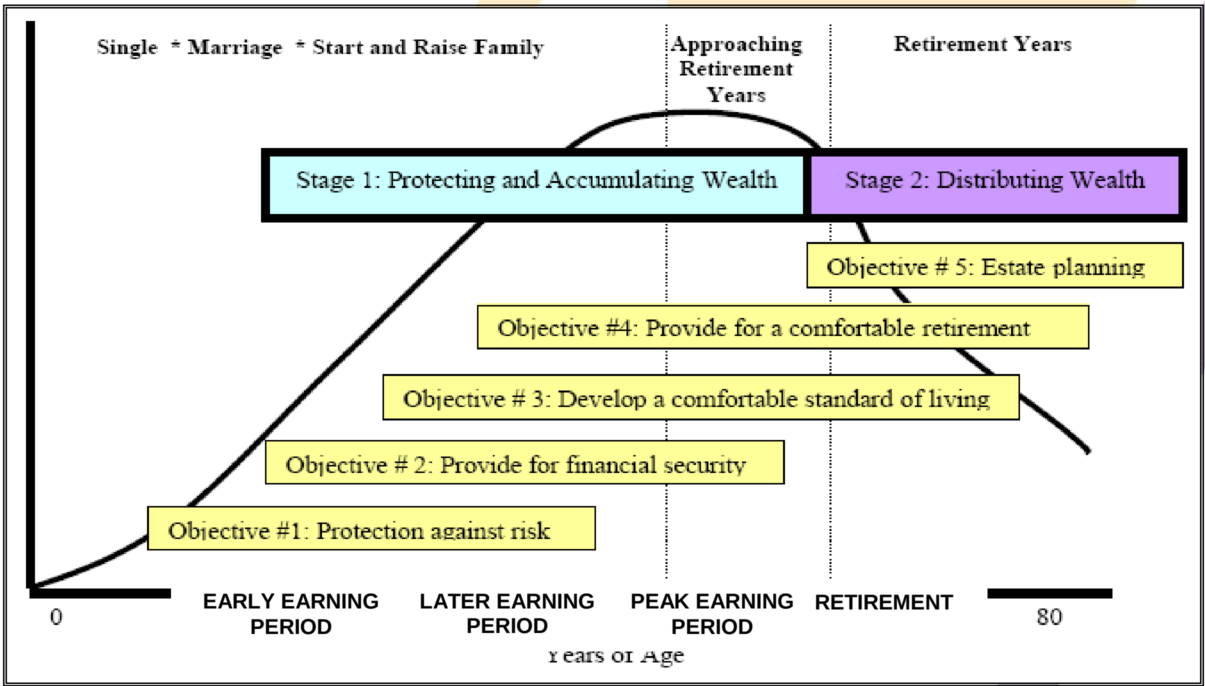
RETIREMENT


PEAK EARNING PERIOD

LATER EARNING PERIOD

#### 1.1.2.2 The Life Cycle of Financial Planning

This model indicates five basic objectives during the lifetime of an individual. These can also be seen as a form of generic needs.



### 1.1.2.3 The Bert Whitehead Financial Life Cycle

The following financial life cycle chart was created by Bert Whitehead, founder of Cambridge Advisors and author of Financial Dysfunction- “Why Smart People Do Stupid Things with Money”. The life cycle chart represents transitional stages in our lives as they relate to our age and our financial progress.

We have adapted the illustration slightly to make provision for the requirements of this unit standard, but the full model can be viewed on www.bertwhitehead.com

| | EARLY CHILDHOOD | CHILDHOOD | TEENAGER | BUILDING THE FOUNDATION | EARLY ACCUMULA-TION | RAPID ACCUMULA-TION | FINANCIAL INDEPEN-DANCE | CONSER-VATION | DISTRIBUTION | SUNSET |
|---|---|---|---|---|---|---|---|---|---|---|
| TRANSITION POINT | Money is to eat | Receive allowance | Earn own money | Become self-supporting | Net worth more than annual income | Investment earnings exceed savings | Investment earnings equal 50% or more of living costs | Live of investment earnings plus retirement pension | Have more money than can spend in a lifetime | Not long to live |
| NET WORTH | | | | Less than own income | 1 – 3 x annual income | 3 – 7 x annual income | 7 – 10 x annual living expenses | 10 – 15 x annual living expenses | More than 15 x annual living expenses | |

| | EARLY CHILDHOOD | CHILDHOOD | TEENAGER | BUILDING THE FOUNDATION | EARLY ACCUMULA-TION | RAPID ACCUMULA-TION | FINANCIAL INDEPEN-DANCE | CONSER-VATION | DISTRIBUTION | SUNSET |
|---|---|---|---|---|---|---|---|---|---|---|
| **ASSET ALLOCATION** | | | | 75% Interest earning<br>25% Equities | 50% Interest earning<br>50% Equities | 40% Interest earning<br>60% Equities | 50% Interest earning<br>50% Equities | 60% Interest earning<br>40% Equities | 75% Interest earning<br>25% Equities | |
| | **0 - 5** | **6 - 12** | **13 - 19** | **20 - 30** | **30 - 40** | **40 -55** | **55 - 70** | **70 - 85** | **85+** | |

**EARLY EARNING PERIOD** **LATER EARNING PERIOD** **PEAK EARNING PERIOD** **RETIREMENT**

## 1.2 The effect of attitudes and values on an individual's perception of wants and basic needs

### 1.2.1 Wants and Needs

One of the most basic concepts of economics is want vs. need. What are they exactly?

A need is something that you have to have. It is an essential element for survival. A few examples include food, water and shelter. If you do not eat, your body would shut down and will lead to death. It is part of who we are and without food you simply cannot survive.

A want is something you would like to have. It is not absolutely necessary, but it would be a good thing to have. A good example is a new pair of shoes. Some might say that it is a need, but if you already have 10 pairs of sneakers, you certainly do not need another pair. It is a desire but not essential for you to survive.

These are general categories, of course. Some categories have both needs and wants. For instance, food could be a need or a want, depending on the type of food.

You need to eat protein, vitamins, and minerals. How you get them is up to you (and your family). You can eat meat, nuts, or soy products to get protein. You can get fruits and vegetables to get vitamins and minerals. You can eat yogurt or cheese to get other vitamins and minerals. You can eat bread to get still more vitamins and minerals. These basic kinds of foods are needs.

Ice cream is a want. You don't really need to eat ice cream to survive. You can eat it to get some vitamins and minerals, but other foods like cheese and yogurt give you more of those same vitamins and minerals without giving you the fat that ice cream does. Still, ice cream tastes good to many people. They like to eat it. They want it, but they don't need it. They like it, but they don't have to have it to survive.

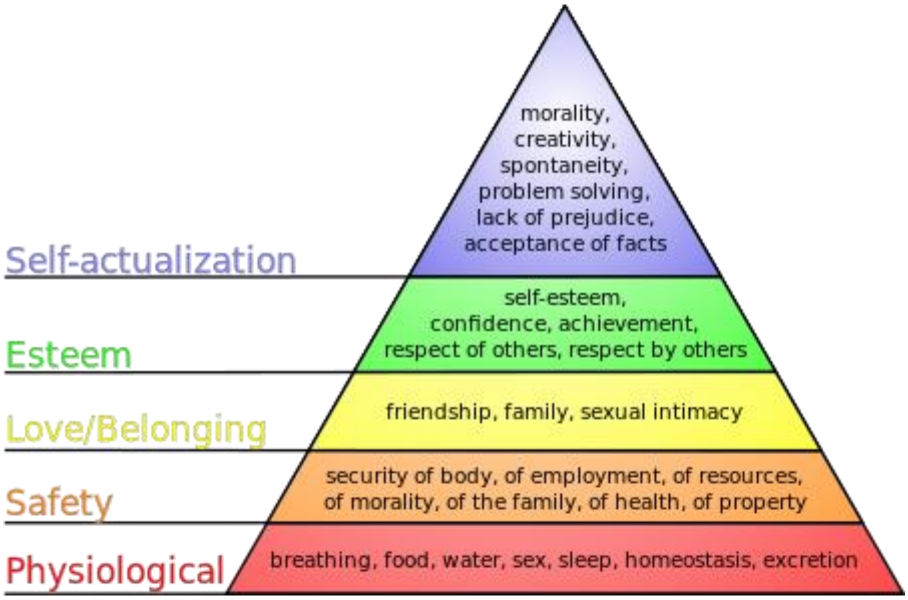
Therefore an individual should consider whether they need or want the particular financial service. A good example is credit, do I really need another jacket, or do I want a new jacket? Equilibrium between needs and wants should be established and the needs and wants evaluated during any financial transaction.

In conjunction with needs and wants, attitudes and values influence our decisions.

### 1.2.2 Maslow's Hierarchy of needs

Maslow's hierarchy of needs plays a significant role in the understanding of how an individual needs can be described. Although the theory tends to published more as a motivational theory, it does give us a clearer understanding of the needs for different individuals. Maslow's theory is most often portrayed in a pyramid. The most basics needs reflect on the bottom and the need for self actualization reflects on top.

The human being is a complex creature and although the pyramid reflects that we all start at the bottom, we sometimes experience different levels at the same time. Maslow acknowledged the likelihood that the different levels of motivation could occur at any time in the human mind, but he focused on identifying the basic types of motivation and the order in which they should be met.



***Physiological needs***

Physiological needs are the physical requirements for human survival. If these requirements are not met, the human body will not survive and might lead to death. These needs are essential and will include air, water, and food. We also need to protect ourselves against the elements of nature, hence why clothing and shelters forms part of the physiological needs.

***Safety needs***

In the absence of safety we will not be able to survive. If war breaks out, the needs will change again to ensure that all individuals can meet their basic need of food and water. Individual will start to experience post-traumatic stress disorder or trauma. During recessions there are less jobs available, and more retrenchments occur. This will then lead to individuals who will feel “insecure” and might lead to people using up all their savings, cancelling their insurance policies, or even leaving the country.

Safety and Security needs include:

- Personal security
- Financial security
- Health and well-being
- Safety net against accidents/illness and their adverse impacts

***Love and belonging***

During adolescent years, the need for love and belonging is very strong. However, most individuals would always have the need to feel accepted and loved. You can relate to someone in your own work environment. They would belong to all committees, boys clubs, social committees, sport teams and even belong to professional organizations. According to Maslow, humans need to feel a sense of belonging and acceptance among the above-mentioned groups.

***Esteem***

Respect is very important within our family, society and work-place. All individuals have the desire for respect in their life and do not necessarily refer to age, race or education. Some people will participate in certain sporting activities and would excel and would thrive on the amount of recognition they would get. Recognition of your work plays an essential role to motivate you in your current job, but the need for recognition will never go away. Esteem presents the typical human desire to be accepted and valued by others.

***Self-actualization***

Once an individual have reached their full potential is they would have reached the top level according to Maslow. It can be from achieving a degree or a qualification or to goals that an individual have. Maslow describes this level as the desire to accomplish everything that one can, to become the most that one can be.
*Source: Wikipedia*

### 1.2.3 Attitudes and Values

Values represent basic convictions that a specific mode of conduct or end-state of existence is personally or socially preferable to an opposite or converse mode of conduct or end-state of existence.

Values are about the perceptions of the individual of what is right and wrong and it thus implies that values have a judgmental element. For example, we judge others according to our own beliefs, principles and preferences. Values are usually very stable and enduring over time.

Attitudes are predispositions to respond to some class of stimuli with certain classes of responses. Attitudes serve as a good indicator of what behaviour can be expected within a certain context. Psychologists believe that changing attitudes is a good manner to modify behaviour.

Robert Kyosaki identified the influence of attitudes and values and described in his book: “Rich Dad’s Guide to Investing” what he identified as procedures that people follow when choosing financial products, specifically, investments based on their attitudes and values.

The following are some of the different types of investment procedures:

- Buy, hold, and pray (long)
- Buy and sell (trade)
- Sell then buy (short)
- Option buying and selling (trade)
- Cost averaging (long)
- Brokering (trade no position)
- Saving (collecting)

He continues by explaining there are different types of investors, with their own product specialties and their investing procedures based on their attitudes and values.

All of this adds to the confusion on the subject of investing because under the banner of investing there are people who are really:

- Gamblers
- Speculators
- Traders
- Savers
- Dreamers
- Losers

Therefore, attitudes and values influence the choice we make based on risk, product supplier, advice from various sources, etc.

## 1.3 The attitudes and values of at least three individuals surveyed and applied to the model and deviations from the model

### 1.3.1 Financial values

A person's goals are a reflection of his or her personal values. Values are relatively permanent personal beliefs about what a person regards as important, worthy, desirable or right. Everyone has values, but everyone does not value the same things equally.

Values tend to reflect a person's upbringing and change very little without conscious effort over a lifetime. For example, some families and individuals hold their faith as a very high value, for others it may be education or a successful family business. It is important that the financial planner recognizes the values of clients with whom they closely interact.

Before we look at the effect of financial values on people, let us first introduce you to a little exercise in order for you to understand exactly what is meant by financial values.

**EXERCISE ON FINANCIAL VALUES**

To help you recognize some of your own money values, read the pairs of words below, then indicate one item in the pair that would be your first choice with an X.

Question:

"If you had an extra R50 000, on which of the two items would you spend your money?"
You must make one choice in each pair:

| | OPTION 1 | | OPTION 2 | |
|---|---|---|---|---|
| 1 | Housing (Dream home/ Vacation home) | | Retirement Savings/Investments | |
| 2 | Education: Self/Others | | Vacation/Travel | |
| 3 | Retirement Savings/Investments | | Hobbies/Sports | |
| 4 | Social Activities/Eating Out | | Car | |
| 5 | Education: Self/Others | | Housing (Dream Home/Vacation Home) | |

| | OPTION 1 | | OPTION 2 | |
|---|---|---|---|---|
| 6 | Personal Appearance/Grooming/Clothes | | Car | |
| 7 | Retirement Savings/Investments | | Hobbies/Sports | |
| 8 | Hobbies/Sports | | Car | |
| 9 | Housing (Dream Home/Vacation Home) | | Vacation/Travel | |
| 10 | Vacation/Travel | | Church/Charitable Giving | |
| 11 | Hobbies/Sports | | Church/Charitable Giving | |
| 12 | Vacation/Travel | | Personal Appearance/Grooming/Clothes | |
| 13 | Church/Charitable Giving | | Social Activities/Eating Out | |
| 14 | Housing (Dream Home/Vacation Home) | | Retirement Savings/Investments | |
| 15 | Hobbies/Sports | | Housing (Dream Home/Vacation Home) | |
| 16 | Church/Charitable Giving | | Social Activities/Eating Out | |
| 17 | Personal Appearance/Grooming/Clothes | | Vacation/Travel | |
| 18 | Retirement Savings/Investments | | Social Activities/Eating Out | |
| 19 | Education: Self/Others | | Car | |
| 20 | Personal Appearance/Grooming/Clothes | | Education: Self/Others | |

Now total the number of times you t each item in the pair activity:

____ Car

____ Charitable Giving

____ Education

____ Hobbies/Sports

____ Housing

____ Personal Care

____ Retirement

____ Social

____ Travel

*(Adapted from the High School Financial Planning Program)*

Now you can rank your values. Write down the values (car, retirement, charity, etc.) having the highest number of "votes" This list reflects the items you consider most important in their order of importance. By knowing your values, you can make sure your goals and attitudes reflect your values. The closer they all match your spending plan, the easier it will be to reach your financial goals and financial security. Did you learn anything new about yourself in this activity?

### 1.3.2 Financial attitudes

Attitudes are a measure of a person's state of mind, their opinions and judgment about the world in which they live. Attitudes reflect a position you have taken with your values and are much more flexible than values. For example, one family may place a very high value on children and have a very positive attitude about raising them and providing opportunities for them. Both spouses may value higher education, yet one spouse may have a more positive attitude toward the University of the North, and the other may have a more favourable attitude toward Stellenbosch University.

The ideal financial attitudes and values in each stage:

**Early earning period**

- Value a pension or provident fund.
- Value the purchase of a vehicle.
- Value savings for a home.
- Value settlement of credit.
- Value re-investing money from previous employer's pension or provident fund.
- Value provision for life cover, funeral cover, disability and critical illness cover.
- Value investments.

**Later earning period**

- Value savings for education.
- Awareness of investment details such as cost and diversification.
- Tax awareness.

- Rebalancing of portfolio in order to make it work effectively from a growth and tax point of view.
- Value investments into a retirement plan to make up for any shortfalls.
- Value the services of a financial planner.

**Peak earning period**

- Bigger focus on retirement.
- Structuring of cash flow.
- Portfolio structuring in most effective way.
- Health care becomes more of a focus.
- Investment options of retirement benefits.
- Tax planning to minimise tax.
- Planning for possibility of low interest rates and effect on income.
- Focus on will and estate planning.
- Personal budget awareness.
- Health care remains a focus.

**Retirement**

- Increased focus on estate planning.
- Awareness of possible increasing in health care expenses.
- Awareness of any risks facing retirement income.
- Increased awareness of sufficient provision for any dependants.
- The leaving of a legacy.

### 1.3.3 Effect of financial attitudes and values

We will now briefly look at the effect that attitudes and values could have on an individual's perception of wants and basic needs.

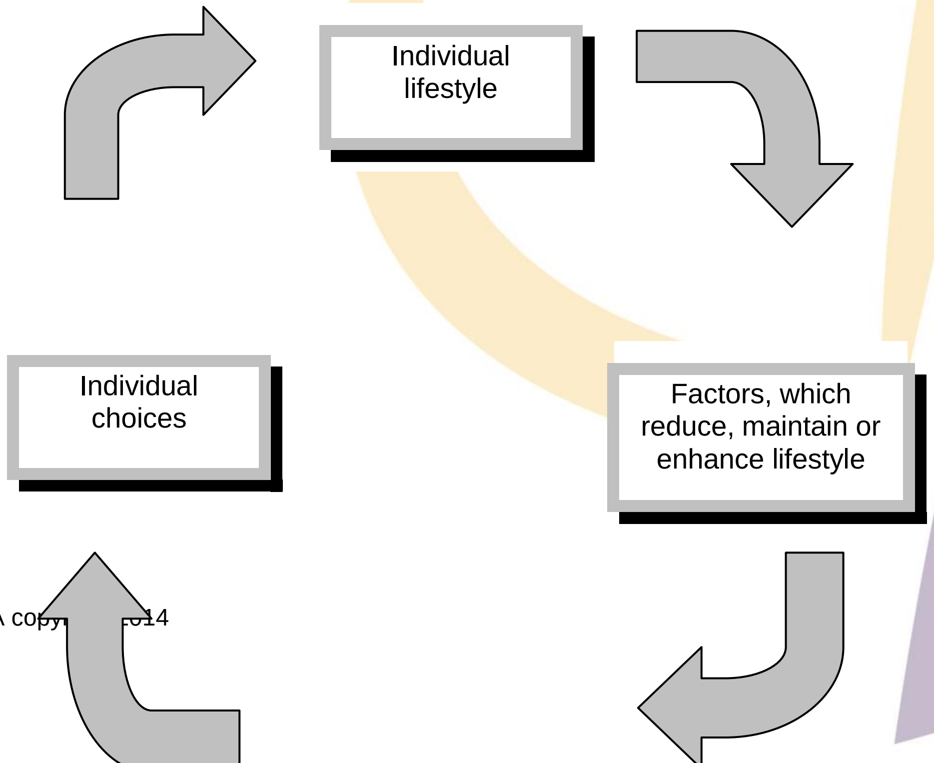
| Values and attitude towards: | Effect | |
|---|---|---|
| | **Positive** | **Negative** |
| **Pension or Provident fund** | Normally take a job where a pension or provident fund forms | If the company does not have a pension or provident fund, they |

| Values and attitude towards: | Effect | |
|---|---|---|
| | **Positive** | **Negative** |
| | part of the package. Alternatively they will invest in a retirement annuity | will not make any efforts to invest in a retirement annuity |
| **Value of possessions** | Realize the effect of possible losses and will invest in short term insurance. | If losses occur, they normally replace the items by means of credit transactions. |
| **Own house** | Do everything to save money for a deposit and will even do without certain luxuries and even possessions to save for a house. | Normally rent a place and buy luxuries to suit their lifestyle. |
| **Saving** | Work with a monthly budget and put away extra money. Entertainment spending is low. | No budget and live in such a way that they do not have any money left by the end of the month.<br>Entertainment spending is high. |
| **Death** | Normally first priority is funeral cover and life cover – even if initial cover is low. Ensure they regularly upgrade cover in line with their needs. | Death is something that happens to other people. |
| **The risks in life** | Take care of life cover, disability and critical illness cover. | It only happens with other people. |
| **Education** | Start saving on a very early stage for education. Stay informed about current and future costs of education. | Struggle to afford primary and secondary education and normally have the attitude that the grown up child must provide for him/ herself. Will sometimes use credit to finance tertiary education. |
| **Investment planning** | Seek the advice of a financial | Money is there to spend. |

| Values and attitude towards: | Effect | |
|---|---|---|
| | **Positive** | **Negative** |
| | planner to assist them. Have knowledge of different instruments and performances of each. | Sometimes they have a savings account. |
| **Retirement planning** | Major efforts to ensure a financially sound retirement. Use the service of a financial planner. | Start to think about retirement 10 to 5 years prior to retirement and often then do nothing about it due to affordability. |
| **Tax awareness** | Ensure that investment portfolios are structured in the most tax efficient manner. | The tax man is there to steal your money. |
| **Health care** | Health care in retirement becomes more of a focus. | Will deal with it when it happens. |

### 1.4 The influence of an individual's occupation and avocations, and lifestyle on basic needs and wants

Factors influencing individuals' financial choices can best be illustrated in the diagram below:



Needs, wants, and attitudes that influence financial decisions

We will now look at two examples that will make the above illustration clear.

**Example 1:**

Nathan Khumalo's lifestyle is that of a person living in Sandton.  The fact that he is a CEO and his wife is a medical doctor enhances this lifestyle. They are both aware of the need to make sufficient provision for retirement and they want to provide their children with excellent education. They have therefore chosen to invest in retirement annuities and educational policies for their children.

**Example 2:**

Koos van der Merwe's lifestyle is also that of a person living in Sandton. The fact that he is a teacher and his wife is unemployed makes this type of lifestyle very difficult. They are both aware of the need to make sufficient provision for retirement and they want to provide their children with excellent education. However, they will have to move to another suburb and change their spending patterns if they want to address these needs.

They don't want to damage their image amongst their friends, so they have decided to stay in Sandton and have therefore made the choice of not investing in retirement annuities and educational policies.

# Module 2

## The dynamic nature of income and expenditure typical at different stages of an individual's life

This Module deals with:

- The change in attitudes and values of an individual over time with reference to the impact of change on income and expenditure
- The expenditure for a minimum of three people at different stages in life, but with the same income is compared in terms of acquisition of assets, savings/investments, preservation of capital and provision for life risk related events (covered in the assessment)

By now you should have noticed that an individual's attitudes and values, income and expenditure and basic needs and wants, normally change over time.

In this module we will briefly explain how these changes occur during the four stages mentioned in module 1. We will firstly look at their wants, then their needs and simultaneously look at expenditure patterns.

### 2.1 The change in attitudes and values of an individual over time with reference to the impact of change on income and expenditure

#### 2.1.1 Early Earning Period

##### 2.1.1.1 Wants

- The want for a home or flat
- Given the costs associated with owning your own home today, it is unlikely that this group will be in a position to do so. They will most likely rent a home. Items like a TV, a sound system and furniture will have to be purchased.
- The want for a car

- Unless they are prepared to use public transport, the desire to own their own car is high on their list of priorities. However, new cars are expensive. They will most likely settle for a used vehicle.
- The want to travel
- An overseas vacation remains one of the main savings wants of individuals in this stage. With exchange rates not favouring the rand, this will require a disciplined savings plan.

#### 2.1.1.2 Needs

- The need to manage their income and expenditure
- The need for life cover
- The need for short term insurance cover
- The need for funeral cover
- The need for health care
- The need to save
- The need for disability and impairment cover

### 2.1.2 Later Earning Period

#### 2.1.2.1 Wants

- The want of a home and furniture:
  - Normally individuals in this stage are married. If they are in a position to reap the benefits of a dual income, their wants are possibly attainable. It might not be their dream home, but it is a start. For most couples who recently got married, often buy less expensive homes in less desirable areas than they would have normally would like. Some other couples would prefer renting a home, especially if there is only one breadwinner. Decorating of the new home can be a stressful exercise as the individuals often struggle to establish a balance between individual taste, convenience, sentimentality and former comfort zones. This generally sees old furniture being sold off or given away to make room for new purchases.
- The want of a car:

- Couples may well have purchased their vehicles prior to the marriage and will bring these into the union and retain them for convenient transport to and from their place of employment.
- Once again, the benefit of two salaries may see an upgrade in either one or both vehicles. Even in instances where the income is less, a purchase of one used or new vehicle is now possible.

#### 2.1.2.2 Needs

- Life cover
- Bond cover
- Short term insurance
- Funeral cover
- Disability and impairment cover
- The need for health care
- The need to save
- The need for further education
- The need for retirement planning

### 2.1.3 Peak Earning Period

The addition of children brings about a shift in focus in the lives of the married couple. As children are the future, the married couple will now feel the need to plan for their children's future and protect it. The couple will take steps to manage their finances more carefully and protect their property and lifestyle against significant changes that could negatively impact on the family.

This will see a blurring of wants and needs. Where a house and car once reflected the aspirations of the couple, the chosen house or car will now reflect the need to cater for the children.

Thus we will only deal with needs.

- The need for a family home
- The need for a bigger car
- The need for life insurance
- The need for short term insurance

- The need for funeral cover
- The need for disability and impairment cover
- The need for health care
- The need to continue saving
- The need for child education

### 2.1.4 Retirement

If in fact, retirement saving has been a commitment during the duration of the individuals working life. Their accumulated wealth is probably at its height by the time they retire. Therefore wants will not be an issue – they will be able to afford them. The challenge now is to manage assets so that they last as long as they do. Insurance will still play an important role at this stage of life.

- The need for a home
- The need for a car
- The need for life insurance
- The need for short term insurance
- The need for funeral cover
- The need for health care
- The need for a tax efficient plan in respect of their regular income

# Module 3

## The interrelationship between an individual's wants and basic needs and the implications for a financial plan

This Module deals with:

- Stages of the financial life cycle illustrated with examples and correlated with the want and basic needs of an individual at each stage
- Potential financial solutions for events that can be planned for to ensure the least possible financial disruption
- Possible lifestyle choices analysed and the analysis is used to predict the potential impact of each choice on the individual's financial situation
- The implications of changing wants and needs on a financial plan

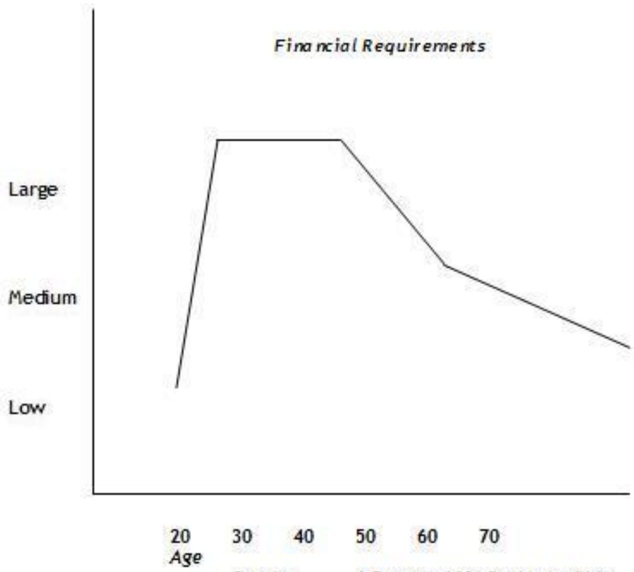
### 3.1 Stages of the financial life cycle illustrated with examples and correlated with the want and basic needs of an individual at each stage

The volume and pace of commercial technological developments are increasing in many industries. New products and processes are being introduced more frequently and, from the perspective of an individual company, there are narrower windows for product introductions. Corporate product development efforts are getting increasingly more sophisticated at surveying and incorporating customer preferences. This pursuit of niche markets demands faster product changes and more flexible marketing, design and manufacturing processes. The implication is that organizations must develop and improve their products on a continuous basis.

It is important to conduct a needs analysis on a regular basis (or at least every 5 years), especially as a person ages and more products become available. This is essential, not only due to new products that are available but also due to the changes in lifestyle as a person ages. When you compare the financial needs of a student (Car Payment, Rent, Education etc) to that of a 42 year old working adult (Car Payments, Mortgage, Education Fees) the responsibilities differ drastically.

Our financial needs will influence our financial planning and choice of products during our different life stages, i.e. entry into the market, established worker, professional etc.

There are certain life stages and events that are common to most of us in one form or another even though we are different, with our own needs and circumstances.




Graph: A Persons Life Cycles and his financial requirements

A person's life can be divided into seven stages. Each stage is characterised by different want and needs, as well as varying challenges and development.

Not all people go through life stages at exactly the same time or in the same manner, but the 7-stage model can still be used as a means of illustrating different wants and needs with relation to life stage.

### 3.1.1 Seven Stage Model

#### 3.1.1.1 Childhood

Childhood can be divided into two sub categories, namely infancy and early childhood. Infancy is characterised by rapid spurts of development. Physical movements are at first diffuse, gradually becoming functionally more differentiated. Cognition develops through the maturation of movement and senses.

In early childhood, body awareness develops – a child learns that they have a body and that they can control it. Sigmund Freud maintained that by learning to control their excretory functions, children acquire a sense of mastery, which in adulthood influences their mastery of tasks. The will starts to develop gradually to reach an adult form after adolescence. The will involves flexible regulation, such as short- and long term goals, resetting them, deciding how to act or not to act in certain situation, and gaining control over remembering, thinking and feeling.

#### 3.1.1.2 Adolescence

During adolescence the child develops into an adult on a physical, cognitive and social level. The age demarcation may vary, but usually adolescence is seen as starting at puberty. During the second phase, formal operational thinking equips the adolescent with the ability to construct theories, either about aspects of the world or of self.

In a next phase, on a moral level, adolescent become socially conscious. Here, concern isn't so much with personal rights but with the welfare of society or the group in terms of roles and rules of the system.

#### 3.1.1.3 Early Life

In early adulthood physical and cognitive development is at its peak. Physically it is a time of energy health and biological vigour. Cognitive functioning is characterised by good memory, abstract thinking ability, problem-solving ability and learning new skills.

Individuals are concerned with establishing independence and responsibility, establishing one's identity, finding a place in and contributing to society.

#### 3.1.1.4 Establishment

Socialisation within the individual's immediate context forms an integral part of establishment. To become socialised involves learning more about the context and becoming adjusted to its expectations, policies, procedures and norms. This can be in a social or corporate setting.

#### 3.1.1.5 Achievement

Once a certain degree of security and acceptance has been established in the context, the individual strives for achievement. The nature of the achievement will vary across contexts.

#### 3.1.1.6 Mid-Life

Mid-life transition and middle adulthood is dominated by conscious ageing, and acknowledgement of mortality and, with that, a potential for increased illness and diseases. Middle adulthood involves physical changes such as loss in bone density and less muscle activity. The risk for respiratory and cardiovascular disease also increases. Psychological benefits include more wisdom, more autonomy, being less driven by instinctual drives, coming to terms with limitations, having social concerns, and a broader life perspective.

#### 3.1.1.7 Life

Physical decline in late life stages is inevitable, for example, motor coordination and speed declines, blood vessels become less elastic, and chronic conditions such as arthritis, high blood pressure or dementia become possibilities. Decline in all areas of cognition is not inevitable. Research based on psychometric measurement, is generally inconclusive about cognitive decline.

In late adulthood, individuals are confronted with not only bodily and possibly cognitive decline, but also socio-emotional losses, such as losing recognition and authority as they retire from work. As a result, individuals become less interested in rewards of society and more interested in utilising their inner resources, thereby finding a new balance of involvement with society and self.

## 3.2 Potential financial solutions for events that can be planned for to ensure the least possible financial disruption

### 3.2.1 Life Stages in Financial Planning

Within the context of financial planning, three life stages have been identified, namely: Accumulation, Preservation & Prosperity. These life stages are influenced by the 7 life stages of a person's life but also can change due to various factors, the most common is age. As you age, it is natural that your life stage will gradually or dramatically change.

There are however, other factors that can cause change as well:

- Employment
- Social Norms
- Political factors
- Economic factors
- Status

Generally, age will determine in which of the following three financial life-cycle stages you belong to:

#### 3.2.1.1 Accumulation stage:

- During the first years' of career, when your incomes tend to increase, you accumulated investments mostly in the form of pension and retirement plan.
- Generally, the amount of debits increases due to mortgages, loans to buy cars or others.

- Within this stage you also gain debts in order to accumulate assets that in time will be paid off.
- In this stage the focus is trying to increase your capital.

#### 3.2.1.2 Preservation stage:

- In this stage your invested assets are starting to grow, and generally your income will exceed your expenses.
- Here the investment emphasis includes not only capital, but how to generate incomes.

#### 3.2.1.3 Prosperity stage fade away:

- This stage starts with the retirement stage in which your pension or retirement plan, social security and investments replaces your salary.
- In this stage priorities are focused on making your investments last throughout the whole retirement stage, and to retain a comfortable life style.
- This stage mainly emphasizes the need to preserve capital and generating earnings.
- This stage also focuses on improving life expectancy and one should divert some of the investments to increase capital.

Your current situation will generally determine the risk level you may take on in choosing a certain type of investment. Usually, young investors can afford a higher risk level due to a longer life expectancy, or more until retirement. Bert Whitehead constructed a diagrammatical depiction of financial planning for each life stage.

When considering investments, the investment companies have identified three portfolios applied during different life stages:

- Aggressive Portfolio
- Moderate Portfolio
- Conservative Portfolio

It is important to note that each person enters the different life stages at a different age. However, as can be seen in the example below, it could be generalised depending on the objectives.

| Life Stage | Age Group | Risk Profile | Objective |
|---|---|---|---|
| 1 | <50 Years | High | Capital growth (100%) |
| 2 | 50 to 60 | Medium | Capital growth (45%)<br>Capital protection and Income enhancement (55%) |
| 3 | 60 to 65 | Low | Capital protection and Income enhancement (100%) |

Life stages is just one of the events and time horizon tools used in financial planning to determine what the financial needs of a person could be at a particular time in their lives.

## 3.3 Possible lifestyle choices analysed and the analysis is used to predict the potential impact of each choice on the individual's financial situation

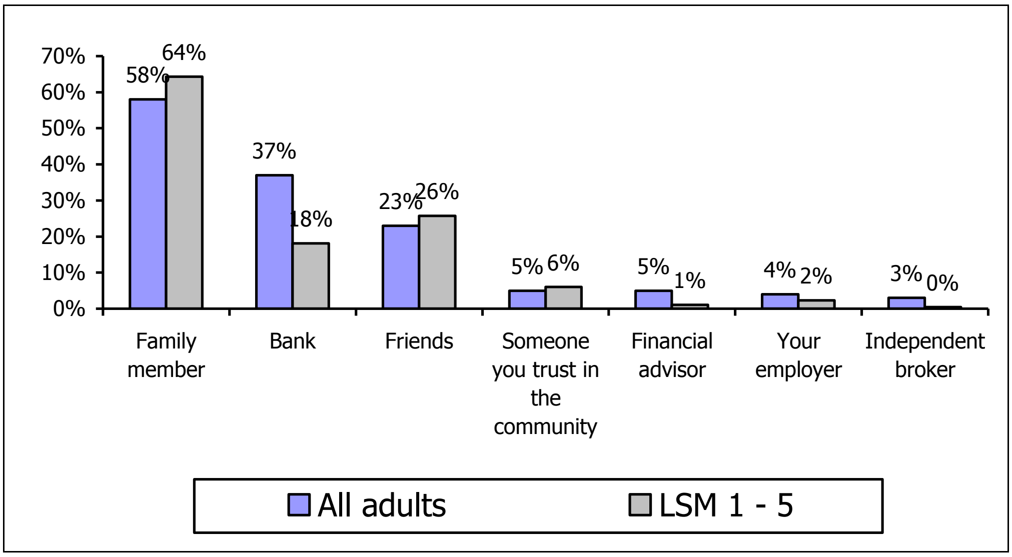
When an individual is faced with a decision, whether it is to buy an ice cream or to make an investment, their choice is directly impacted by their wants and needs at that moment as well as their attitudes and values.

When the individual is faced with a difficult decision and requires advice, the majority of South Africans turn to friends and family.

### 3.3.1 Statistics and Advice

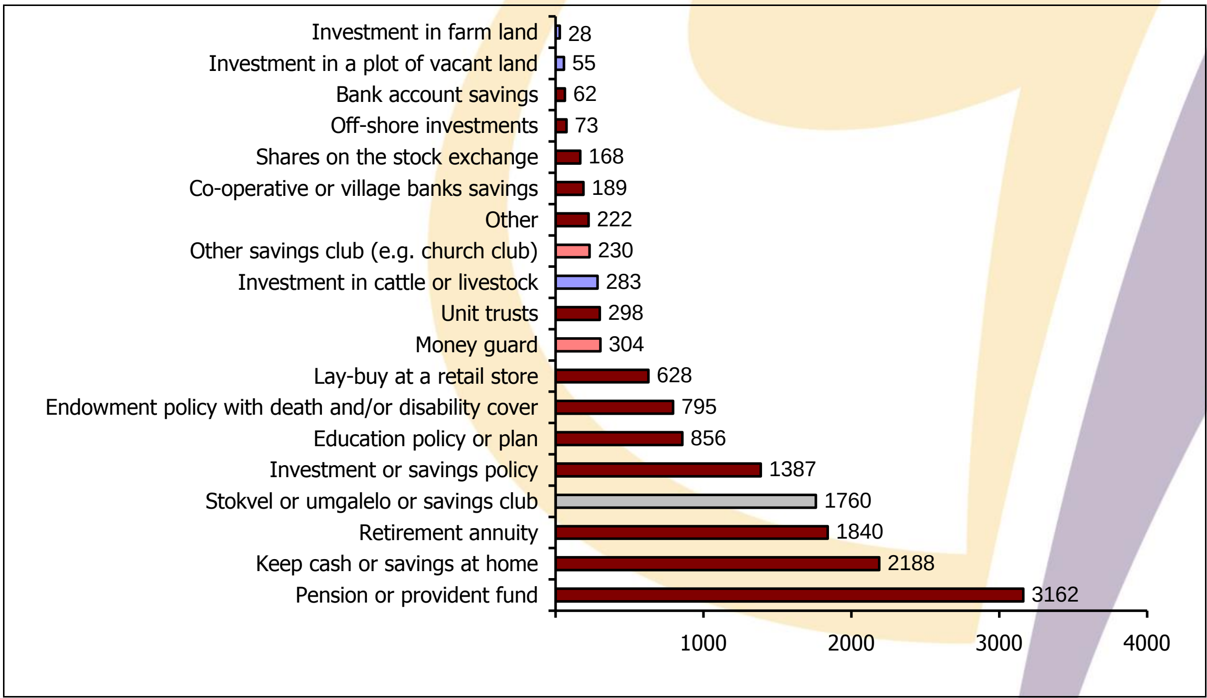
In a recent survey by FinScope, it was identified that the majority of people still rely on family members and friends for financial advice.

**If you need financial advice, who do you ask for help?**




Therefore it is clear that the majority of South Africans, when choosing voluntary financial products, rely on their family members and friends. Financial education is thus of the utmost importance. It is safe to assume that very few of the friends or family members are qualified to offer financial advice and thus the same mistakes will be made.

During 2007 FinScope identified the various financial services used by South Africans. It was identified that the usage of voluntary products is relatively low, with compulsory products being the highest.



# Module 4

## Critical events that trigger entry into a new stage in the financial life cycle

This Module deals with:

- Events that can trigger entry into a new stage in the financial life cycle and an indication of the potential financial impact of each event on the financial plan
- Changes in the external environment that can impact on an individual's financial plan with reference to the political, legislative, social, economic and physical environments
- Possible solutions to manage changes in an individual's wants and basic needs from one stage in the financial life cycle to another for different scenarios

In this module we take a closer look at the different events that trigger a new entry into a new stage in the financial cycle and how that impacts the individual's financial planning, how changes in the external environment influence the financial plan by naming these external influences.

You will see that a person's financial needs and wants go through a constant evolution in their entire lives. Each individual have unique needs within the financial planning cycle despite these needs being almost similar and applicable to everyone.

### 4.1 Events that can trigger entry into a new stage in the financial life cycle and an indication of the potential financial impact of each event on the financial plan

#### 4.1.1 Marital Status

A change in a person's marital status triggers a new step in life and has financial implications connected to it. For example: Newly wedded couples do not only have to make financial provision for their most basic needs and wants; i.e. buying a house, car, groceries and payment for expenditures; but also have to provide for their future unforeseeable needs. These future needs may include having to make provision for possible job loss for either one of the spouses or death of either spouse.

Divorce or death of one of the spouse (widowed) has definite financial repercussions on the financial life cycle of a person, especially when marriage was entered into by way of in community of property. These individuals will have to share each other's estate, settle their debts incurred during their marriage and make new decisions regarding financial plans in terms of their single hood. Where are they going to stay and the affordability of the place in question is just but a few of many financial implications that a new stage in life would influence their decisions? This can have negative or positive spin-offs on the finances of the surviving or one of the divorced spouses provided correct advice is given to the individual.

#### 4.1.2 Starting a new family

It is imperative for the parents during this moment in time to make provision for their children's short to long-term financial security. Children have day care to attend, special food to be prepared, schooling up to tertiary level, extra-mural activities, pocket money, etc. A parent who has not made proper financial planning in this stage of life will definitely suffer the consequences in future.

#### 4.1.3 Buying a new home

The intrinsic payment structures that are attached to property contracts could be cumbersome for a layman to comprehend. One should also consider the monthly and unforeseeable future maintenance of the property, the current tax implications (Capital Gains Tax), including death of one of the spouses.

If not provided for financially, the implications could be devastating and may result in the loss of property, repossession of the house or even to a larger extent, rapid loss of value of the house.

### 4.1.4 New occupation

A voluntary or involuntary lifestyle change is certain, whether a person is entering the labour force for the first time, getting a promotion or changing one employer for another.

In reality, it has been established that an increased income will trigger a higher expenditure. In this context individuals tend to misuse their newly acquired income packages by engaging in debt traps in order to maintain the new lifestyle. They fail to make provision for their future financial needs. Lack of better financial provision is also one of the most major causes of divorces these days, therefore, curbing this negative effect not only is a morality issue but a lot of necessary savings on expenses not budgeted for.

### 4.1.5 Support for aging parents

During these days a lot of people find themselves increasingly having to support their ageing parents. While it is not any of the parties' involved wishes to take care of or be taken cared for by another, nonetheless, the situation prevails. This is mainly due to the unforeseen pitfall that lay ahead by the parents during their youthful years and their children's lack of better judgment to foresee the future.

The situation is fuelled by the fact that many couples do not want to live with their parents given their parents' nature of demands, especially those demands that have been brought about by ill health or incapacitation.

Regrettably, it is these children who have to support their parents and would have to bear the consequences of looking after their ageing parents.

With careful financial planning they can prevent costs that they would have incurred, like renting a retirement home for the parent, paying medical bills or even taking time off during illness or hospitalization. Nobody wants to be a burden on their family, hence the importance of preparing financially for parents who did not make enough provision for their retirement.

### 4.1.6 Changes in individual businesses

One of the critical keys to the success of the business rests with the owner being able to adapt to changes. The changes may come in the form of new technology within the business industry to reduce costs, need for specialised labour, and expansion of the business, diversification of products or service ranges. There are numerous reasons why a business may need to change and they are often prone to financial implications.

However, when these changes are made sound management of these changes is highly advised. The business debt ratio may have increased, more employees hired and the value of the business may have changed. All and more these need to be financially provided or else the business owner risk losing the business due to poor financial planning.

### 4.1.7 Health Status of an individual

Every one of us lives life without the expectation that we may find ourselves in dire straits with regards to our health. We smoke recklessly, we drive our cars recklessly and still blame the taxi man for our mistakes, sometimes we cross roads without even giving a flinch to the on-coming traffic - yet we expect to forever be in prime health status.

Everyday at least twelve 12 people die due to road accidents, 23 become permanently disabled due to road accidents, almost three times as much become partially disabled but with permanent scars and over a three hundred die due to lung cancer caused by smoking cigarettes. Despite these facts and still knowing them we still persist on living on dangerous grounds.

While it is increasingly becoming compulsory for employees to take health insurances some people refuse to take any. Their excuses are often met by the same answer: "*We cannot afford to take medical aid cover*" and often feel vindicated by their answers. Failure to take care of one's medical needs have led to people who could have been saved of their health burdens being left out due to their failure to make financial provision for this aspect.

### 4.1.8 Planning for retirement

People tend to confuse retirement planning with pension or provident funds. Mentioning of retirement fund blindly makes them to believe that their pension funds will set them up for a splendid retirement.

Statistics prove that only 10% (if not less), of South Africans are set to retire comfortably while the rest are in a sorry state. Given the way we are going, it means that 90% of the labour force is going to have difficulty in surviving throughout their retirement years unless they start making provision for retirement planning, the sooner the better! As one gets older it is going to be increasingly difficult to be able to live a comfortable life during retirement even if one makes concessions to retirement planning.

Furthermore, during a person's death that money that has been put aside for provision of retirement can be put to good by consulting financial planners. But like it has been mentioned earlier, most of our parents are not adherent to the advice of financial planners sighting mistrust.

## 4.2 Changes in the external environment that can impact on an individual's financial plan with reference to the political, legislative, social, economic and physical environments

As the external environment is always changing, changes into the individual's financial plan become a continuous process. The external environment in South Africa, Africa and the Global World has undergone significant change recently and it meant we need to adjust our own financial plans accordingly with a complete portfolio redesign.

Without going into detail, we will now mention the most important changes in the external environment that could have an impact on the individual's financial plans.

- Political changes
- Legislative environment

- Social Changes
    - The use of credit facilities
    - Substance dependency
    - Gambling
    - Lack of financial planning
    - Health status
    - Migrant labour and extramarital relationships
- Economic Changes
- Physical environments

## 4.3 Possible solutions to manage changes in an individual's wants and basic needs from one stage in the financial life cycle to another for different scenarios

This assessment criterion is covered in the Learner Work File and needs practical application.

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