FINANCIAL LITERACY FOR YOUTHS

Financial Management for Fresh Graduates

Students are under the impression that life after completing their higher education is fun and stress free as they are no longer bound by the heavy loads of homework, assignments, as well as examinations. Little do they know that their new-found freedom is merely a thin layer of fog disguising one of life's greatest responsibilities – Financial Management.

The term "Financial Management" is not as easy as it sounds because it requires more than just saving and spending, which we have been doing for the past 20 years or so. To cut to the chase, financial management refers to the efficient and effective management of money which can be achieved by understanding the difference between one's NEEDS & WANTS and this can be done through the creation of a budget plan, which will be discussed later in this article.

- Need: Goods or services that you require to survive. (eg. Food, clothes, shelter).

- Want: Goods or services that are not necessary but that you desire or wish for. (eg. Gaming laptop, entertainment, jewellery).

* However, a desire to upgrade/overspend on your NEED will thus, make it a WANT. (eg. Regular coffee vs Starbucks coffee).

<u>Understanding Malaysia's Income Tax, EPF and SOCSO</u>

*This segment will be discussed under the context of Malaysia's fresh graduates.

Income tax, EPF and SOCSO are statutory deductions from an employee's salary which most fresh graduates are not well informed of due to low financial literacy. A good understanding of these contributions will allow an individual to have an extensive understanding of one's income, and thus, be able to develop a solid budget plan to follow through.

- **Income Tax**

  http://www.hasil.gov.my/index.php (under Individual -> Income Tax rates)

2017 Malaysia Personal Tax Rate for Resident

Chargeable Income (RM)	Tax Rate (%)	Tax Amount (RM)
1-5,000	0	0
5,001-20,000	1	150
20,001-35,000	5	750
35,001-50,000	10	1500
50,001-70,000	16	3200
70,001-100,000	21	6300
100,001-250,000	24	36000
250,001-400,000	24.5	36750
400,001-600,000	25	50000
600,001-1,000,000	26	104000
Exceeding 1,000,000	28	

The table above shows the income tax rate as of year 2017 for all Malaysians. Do take note that:

Chargeable Income = Taxable Income

(Total annual income minus tax exemptions and tax reliefs)

-Tax exemptions = amount of income that are excluded from taxation (eg. Tax free)

-Tax reliefs/deductions = amount of income that are eligible for reduction (eg. Tax deductible)

These tax rate only applies to your annual income that falls between the ranges of chargeable income. It is important to know how much income tax you're liable to pay. For example:

-Assuming your annual income is RM25,000 and thus, your income falls between the RM20,001-RM35,000 range; the initial RM20,000 is not taxed, the remaining RM5,000 (RM25,000-RM20,000) is taxed at 1% amounting to RM50 (RM5,000 x 1%).

• **EPF (Employees Provident Fund)**

EPF is a mandatory monthly contribution by an employee in addition to their employer's contribution which will then be credited into the employee's EPF account. It serves as a savings account that guarantees a minimum of 2.5% annual dividend.

Many might not know that an individual EPF account will be divided into Account 1 and Account 2 with the monthly contribution being divided 70/30 into each account respectively. EPF is often mistakenly thought of as a retirement fund, when in fact you can make a pre-retirement withdrawal from Account 2 for housing, education and medical purposes. If there are no early withdrawals from Account 2, the member can then withdraw from both Account 1 and Account 2 either fully or partially upon retirement at the age of 55 (you may even extend your EPF savings until the age 60 to enjoy savings dividend).

• **SOCSO/PERKESO (Social Security Organization)**

SOCSO contribution amount (in addition to employer's contribution) is relatively minimal compared to income tax and EPF. SOCSO is undeniably important for all working individuals regardless of age, and more so for fresh graduates with a moderately low monthly salary. More emphasis is placed on fresh graduates as this group of individuals are unlikely able to afford expensive medical bills. SOCSO will serve as a protection/insurance to compensate workers for injuries or sickness due to work and non-work related injuries (eg. Hearing loss due to prolonged exposure in a noisy working environment). This covers the medication expenses that usually causes a headache when planning a budget.

Short-term Financial Planning

The greatest test you will face after getting your monthly paycheck is to prevent yourself from "redesigning" your lifestyle. A months pay of RM3,000 will appear to be immensely contrasted compared to your past stipend of RM500. You will be enticed to alter your way of life in a portion of the following ways.

What to do: Budget

Since budgeting enables you to make a plan and check up on your cash inflow and outflow, it makes sure that you will have enough money for the bare necessities which are crucial to your wellbeing. Following a budget will ensure that you are on track with your financial goals while building good credit and avoiding debt.

Personal Budget Template:

Fill in the following information to track your spending and adjust your spending habits if it conflicts with your financial goals, e.g. 10% for savings/investment

1. Your Anticipated Income (e.g. RM 3,000/ month)
2. Things You Have to Pay For (student loan payment, contribution towards medical insurance and company retirement plan, credit card payments)
3. What You Have Left for Living Expenses (Part 1 minus Part 2)
4. Your Living Expenses (Housing, Utilities, Food, Transportation, Clothing, Savings and Investments)
5. The total amount of money left (Part 3 minus Part 4)

Bonus: Some Reasonable Budget Guidelines

Some Reasonable Budget	30%
Student loan repayment	8%
Food (includes groceries and eating out)	10%
Credit card, auto, and personal loan repayment	12%
Transportation (includes car payment, insurance, gas, and maintenance)	15%
Clothing	5%
Medical and dental expenses	5%
Savings/Investment	10%
Miscellaneous	5%

What not to do: Try not to Upgrade Your Life after You Begin Working

Personal Variable Expenses: Living Expenses

i) Thank God It's Friday (TGIF) meal with your companions at eateries and drinks at a bar. This could without much of a stretch, set you back by RM75 every week and RM300 a month. *RM75 x 4 weeks = RM300* →Suggested solution: Plan couponing in advance or try biweekly TGIF.

ii) Expanding your shopping expense to fit into the culture of your workplace. This is when one begins purchasing Brooks Brothers or J.Crew suits, shirts, ties and shoes. Once more, this could tire your expenses for the month. →Suggested solution: Invest in a few keys pieces, and slowly.

iii) Taking Grab or Uber will often cost you more once you sum up the total expense of all the rides taken in a month. Regardless of whether or not you abstain from purchasing an automobile, taking taxis will cost you an additional couple of hundred ringgit each month if you are not watchful about it. →Suggested solution: Use GrabShare if you really need it or walk a few blocks away from the crowd for a better fare.

iv) Expanding your day to day expenses pointlessly will signify a considerable sum of money every month in the event that you don't budget firmly. For instance, a RM7 breakfast every day followed by a RM15 lunch and a RM20 dinner consistently during weekdays will set you back by RM840 every month. *(RM7 + RM15 + RM20) x 20 days = RM840*. →Suggested solution: Plan out your budget before you head to the food court or restaurant.

v) Expanding your monthly expenses excessively can, likewise, be impeding to your financial wellbeing. Examples of these ‘necessities’ are a fitness gym membership, the facial, manicure and pedicure package, the 60GB mobile plan and a Netflix subscription. Every one of these expenses will exhaust one’s income for the month. →Suggested solution: (1) Change your plan, (2) Switch service providers, or (3) Cut down on usage.

In any case, with regards to personal variable expenses, fresh graduates can simply endeavour to lessen their costs whenever they need to. Be that as it may, personal fixed expenses can't be effectively changed without the individuals having some type of losses.

Personal Fixed Expenses: Transportation Expenses

A fresh graduate who just began work may end up in a position where he can afford to spend more on private transport. He could take more taxi/cab rides and may even spend up to RM800 a month on taxi fares. This may sound extreme, and it presumably is, however, it is yet a cost that he can decrease whenever he needs or wants to. On the other hand, buying a car and having a monthly expenditure of RM800 or more for loan payment and maintenance, represents a fixed monthly expense to his expenditure and it is a non-avoidable cost even though it may incur some loss. The best way to end this commitment sooner is to dispose off the automobile and thus, significant losses will be incurred as a result.

Personal Fixed Expenses: Financial Products (insurance, saving and investment products)

It is normal to expect that financial products ought to be useful for your monetary wellbeing, but that isn't always the case.

After landing your first position, you are probably going to be flooded with financial advisors requesting for meetups with you. These financial advisors will be eager to teach you about the significance of insurance, saving and investing. Obviously, they will endeavour to pitch their products to you since their employment relies upon it.

It is critical to be prudent when purchasing such financial products. With regards to insurance, ensure that the premiums you are paying are not more than necessary. Regardless of whether they seem acceptable, you have to remember that you have other financial obligations too, which are (1) building up an emergency fund and (2) to begin investing early. Don't let your monthly paycheck be spent on something that does not give you a decent return on the future. Keep in mind that spending a ton of money on insurance is not the equivalent to being financially dependable.

In contrast to making personal investments occasionally, such financial products won't furnish you with much flexibility if you fail to pay the premium for any month. In some occurrence, when premium payments are missed and cash surrender value is exhausted, this could bring some big losses, as you could lose a large portion of the premiums you paid, regardless of the performance of your investments. All things considered, we urge fresh graduates to invest some time in understanding some key investing concepts and to make investments specifically themselves. It is inexpensive and gives you significantly more adaptability over the long haul.

Fresh graduates ought to be wary at whatever point of time they are considering to include a fixed expense in their expenditure. Before committing, it is always astute to weigh in whether or not withdrawing that fixed expense later on would bring a substantial cost.

Medium Term Financial Planning

Over a longer term, debt management is essential to ensure effective financial management. Debt management involves identifying the types of loans and compulsory expenses which includes car loan, housing loan or rental expense as well as student loans. Upon identifying all these elements that will siphon the money from your pocket, the next step will be to devise a plan on how you should pay these off.

Therefore, it is crucial to take into consideration the outstanding loan amount, duration of repayment, interest charged as well as the inflation rate. By doing so, one can view his or her own financial position in the coming years until these liabilities are being paid off, hence, allowing for adjustments in income allocation if one wishes to settle these payments faster. Ideally, one should focus on paying off short to medium term loans, such as student loans, as soon as possible to reduce one's financial burden and interest accumulation that may accumulate and make up a considerable amount over time. It is also exceptionally crucial for one to avoid the common trap that most people fall for, that is, to acquire another form of debt once an old debt is settled.

While it is tempting to acquire a possession with the extra money available, buying an asset and a liability can have an opposite effect on one's financial position. In simple terms, an asset generates income while a liability creates expense. For instance, a property purchased that is let out for rent is an asset as it generates income in the form of rental while it is a liability when it is used for personal use as no income is generated. Inevitably, it is important to identify your financial circumstances and focus on your ultimate financial goals by sticking closely to what is planned while avoiding temptations.

<u>What's next after expenses and debts? (Long Term Financial Planning)</u>

To complete the puzzle, the last step would be to focus on asset expansion. Frequent budgeting and debt management allows for control and allocation of a given amount of income but asset expansion will allow for a more liquid cash flow which may ultimately reduce one's overall financial burden over time. As the term suggests, asset expansion involves investment to grow your money. In general terms, asset expansion involves creating and growing a passive income to finance debt repayment.

For those with a better financial position or have even achieved financial freedom, their passive income is sufficient to pay off their debts while supporting their living expenses. It is hence safe to say that those who achieve financial freedom are comfortable with early retirement as they have a consistent income inflow that can support their living without having to work and depend on their monthly paycheck. As tempting as it may sound, there are various forms of investments and investors varying in terms of knowledge, risk tolerance, desired return and time frame. It is important for individuals to first identify the kind of investor that they are.

While investment involves risk, some factors to consider would be on what to invest and how to invest. As there are many forms of investment, it is essential to first identify the form of investment that one is most comfortable with in order to reduce the risk of investment. A form of investment that one is most comfortable with would ideally mean that one has the best know-how on this particular form of investment compared to the rest. This involves understanding its operation, management structure, performance indicators, as well as the transaction medium.

As for how to invest, the best way is to first identify one's risk tolerance and design his or her respective portfolio accordingly. After all, there is no guaranteed return on investment and the best way would be to diversify and minimize risks for a more secured return.

Conclusion

As a conclusion, financial management is a compulsory lesson for all fresh graduates and this, by all means, goes beyond what was commonly mistaken to be merely allocating for regular savings and spending through budgeting. In fact, effective financial management involves a range of precise work from planning, strategizing, and executing to conducting performance analysis for both short and long term gains. As complicated as this may sound, understanding financial management should not take you a longer time to learn than rocket science. Since Rome was not built in a day, it is advisable to start early and financial freedom will no longer be a dream!

References

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