Importance of setting up a contingency plan

Pandemic brings into focus the importance of having a contingency fund

The outbreak of the mega-pandemic has shattered several illusions over stability and taught us that it is impossible to anticipate the specificity of risk and uncertainty. Nobody would have ever envisaged that businesses across the globe collectively could come to a standstill. No one's worst-case scenario had a COVID-19 pandemic pencilled in for 2020. These were the thoughts best reserved for a movie script.

"In life's journey, having the ability to predict the future gives us an unfair advantage. If we can understand the laws of cause and effect, anyone can predict the future. What we do today leads us to tomorrow's destination. Why does this simple truth seem to be difficult for people to understand?" goes a famous saying from Celso Cukierkorn, the author of the bestseller - Secrets of Jewish Wealth Revealed!

No stratum of society was exempt from the effects of the pandemic and its associated fallouts. Everyone's cash flow was impacted, be it the salaried class, a businessman, or an industrialist. A salary cut or even job losses across sectors pinched salaried individuals and significantly impacted one's cash flow. While inflows were drying up, financial obligations in the form of EMI, rent or household expenses remained static.

Nitish Purohit
Partner - JNV Advisors LLP

Businessmen were affected on a different scale when their businesses were shuttered due to the mandatory lockdown, leaving them with a fixed cost and no income. Even large-sized companies found themselves leveraged in the form of honouring employee salaries, loan interest payments, and several other obligations related to operating costs. The events made a dent in the finances of these industrial houses, even though it may be short term in nature.

These unprecedented times have taught each one of us the importance of having a contingency fund or an emergency corpus to sail through the storm. The other paramount learning through these challenging times is the importance of planning cash flows. When times are good, most of us have a vague understanding of our cash inflow and outflow, but distressed time focuses on several aspects which we often tend to leave on the peripheries.

This is where financial planning steps in. Every individual has a variety of short term and medium-term financial goals to achieve over a period of time. Retirement, kid's higher education and marriage are a part of long term financial goals. These goals can be comfortably reached only if one makes calculative plans, using various financial products.

However, amidst all these planning we often fail to set up an emergency fund that will take care of the investor and his loved one during rainy days.

The thought process behind creating this emergency corpus should be meticulous. Never fall for the trap in setting the goal of some rounded numbers like Rs 3 lakh or Rs 5 lakh. The ideal approach is to keep aside the yearly expenses as your emergency fund. To help deliver a realist plan, tally all the items of your monthly expense plus your fixed financial obligation. The sum may look formidable but it is worth keeping aside for uncertainty emanating due to instances such as health ailment, loss of a job, or even loss of life. Just like any other financial goal, one should save a part of one's income in a planned and systematic manner for this objective. Lastly, do not let this amount lie idle in a savings bank account. Deploy this into a liquid or a short term debt mutual fund where the amount will earn you some gains, easing the burden of reaching your target figure in a profoundly disciplined manner. ■

(nitish@kcplindia.com)