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B.Com Honours | Semester II | Calicut University

Financial Literacy

Course Code: COM2FM106 • Module 1 Notes

1. Financial Literacy: Goals, Budgeting, and Debt Management

Financial literacy is the possession of the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources. Developing financial competence early in life is a key determinant of long-term economic security. This module covers the concept and components of financial literacy, financial goal setting, budgeting, the effects of inflation, the 50-30-20 budgeting principle, compounding, the Rule of 72, and CIBIL credit scoring.

Setting Financial Goals & Components of Literacy

- **Financial Goals:** Divided into Short-term (under 1 year, e.g., emergency fund), Medium-term (1-5 years, e.g., buying a vehicle), and Long-term (over 5 years, e.g., retirement, home ownership).
- **Components of Financial Literacy:** Comprises Financial Knowledge (understanding concepts), Financial Planning & Budgeting (managing cash flows), and Financial Discipline (avoiding impulse spending).

Savings, Inflation, and the Time Value of Money

Inflation & Purchasing Power

Inflation is the rate at which the general level of prices for goods and services is rising, eroding the purchasing power of money over time. To maintain wealth, investment returns must exceed the rate of inflation.

Time Value of Money (TVM)

A sum of money in hand today is worth more than the same sum in the future due to its potential earning capacity. This forms the basis of **Compounding**—earning interest on interest over time.

The 50-30-20 Rule & Rule of 72

Marketers and financial planners recommend structured guidelines for managing personal income:

- **50-30-20 Budgeting Rule:** Allocate 50% of after-tax income to *Needs* (housing, food, bills), 30% to *Wants* (dining out, hobbies), and 20% to *Savings* and debt repayment.
- **Rule of 72:** A simple formula to estimate how many years it will take to double an investment at a fixed interest rate:
  (ext{Years to Double} = 🡅rac{72}{ ext{Annual Interest Rate}}) (e.g., at 6% interest, money doubles in (72 / 6 = 12) years).

Debt Management & CIBIL Score

Debt Management involves balancing borrowing costs and keeping debts at a sustainable level. Lenders in India evaluate creditworthiness using the **CIBIL Score** (ranging from 300 to 900). A score above 750 is considered excellent, qualifying the borrower for lower interest rates and faster loan approvals. The score is built on payment history, credit utilization ratio, and credit history length.