

The Role of Financial Planning in Managing Personal Finances of Middle-Income Households

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ABSTRACT: Financial planning plays a vital role for middle-income groups as a means of managing limited and known sources of income. The increasing cost of living, mounting debts and unstable economy make financial planning essential for such households in order to preserve their stability. The research study conducted—"The Role of Financial Planning in Managing Personal Finances of Middle-Income Households" is aimed at evaluating the efficiency of practices of financial planning including budgeting, borrowing, insurances, tax planning, and financial literacy. Primary data for the research have been obtained by means of a structured questionnaire filled by 286 respondents; statistical analyses have been performed by means of descriptive statistics, chi-square test, and Pearson correlation. It appears that there is an important gap between awareness of personal finances management and its implementation. While about 55.6% of respondents adhere to monthly budget, according to chi-square test there is no significant relation between budgeting and saving ($p=0.317$). Almost half of respondents (53.5%) incur loans; in addition, almost all interviewees use insurances not to save money, but to avoid paying taxes. Significant positive correlation has been shown between financial literacy and decision-making ($p<0.05$).

KEYWORDS: financial planning, middle-income households, budgeting, loan management, insurance planning, tax planning, financial literacy, personal finance

I. INTRODUCTION

Financial planning entails an organized procedure through which an individual plans his/her earnings, spending, savings, investments, and risk management. Financial planning has become mandatory for middle-income families in India, meaning those living in urban or semi-urban settings who earn through salary or own small businesses. The duties of such people have become multifaceted since they have to deal with household expenses, their children's education, health care, debt repayment, and retirement planning while earning a limited amount of money.

It should be noted that middle-class households form the core of Indian society as far as contributions in consumption, savings, and investments are concerned. Unfortunately, these people find themselves unable to plan their finances because of various reasons ranging from high inflation rates to lifestyle issues coupled with credit cards and internet facilities. This generation of the Indian population is increasingly becoming incapable of saving money.

The situation is worrying since it has been observed that most earning households make estimations about their budget without keeping a proper written budget. Savings are made in terms of whatever extra money that comes at the end of the month after paying rent, tuition fees, and EMIs. Retail credit and credit card balances in banks indicate an increase every year. Most middle-income individuals spend around 35% – 40% of their income on EMIs with limited chances to save or invest their funds. The majority of the insured individuals do it for tax savings purposes alone. In general, the Indian middle-class engages in tax planning during the final quarter of the year.

This research focuses on assessing the effectiveness of financial planning among middle-class households, specifically determining the link between the major components of financial planning such as budgeting, loan management, insurance, tax planning, and financial literacy and financial planning effectiveness.

II. LITERATURE REVIEW

There is an extensive body of literature supporting the normative need for financial planning and revealing shortcomings in implementing this practice. Gupta and Kaur (2018) showed that the vast majority of Indian urban households were conscious about the idea of financial planning but lacked consistency in actual performance, showing marked divergence between savings behaviour and intentions. Sharma (2019) revealed that budget-minded individuals performed considerably better in their financial affairs, despite failing to follow their own plans.

Speaking of savings, Patel (2016) established that budgeting had a positively correlated but tenuous effect on household savings. Joseph and Varghese (2020) revealed that even those households that tried to implement a budget suffered greatly from lifestyle inflation and impulse expenditures.

As regards loan dependency, Kumar (2018) showed the harmful impact of growing household debt levels, and Mehta (2020) and Singh and Bansal (2021) pointed out that rising EMI costs limited the ability of middle-income Indians to save and invest money. As another negative impact of household loans, Thomas (2022) mentioned the lack of clarity among working professionals regarding their total debt burden vis-a-vis their incomes.

Studies devoted to insurance planning indicate an unmet need for coverage and reveal inconsistent motivation for purchasing policies. Rao and Mishra (2017) showed that Indian people purchased insurance mostly for tax savings reasons instead of addressing needs, leading to poor coverage. The Insurance Regulatory and Development Authority of India (2019) confirmed persistently low insurance penetration in India. Post-COVID-19 studies by Verma (2021) observed a short-lived boom in interest in insurance products without increasing coverage adequacy.

As far as tax planning goes, Nair (2016) and Kulkarni (2019) found that salary holders engaged in such activities only in the final months of each fiscal year and rarely integrated their tax planning into financial plans. Chatterjee (2020) suggested that effective tax-planning strategies aligned with financial goals could greatly boost wealth accumulation, a potential that the bulk of the middle-income earners failed to tap into.

The significance of financial literacy in planning finances cannot be overestimated. In their work dedicated to middle-class families in the US, Lusardi and Mitchell (2014) found that higher financial literacy levels went hand in hand with planning for retirement and accumulating assets. In support of these conclusions, the OECD (2018) revealed similar tendencies in developing countries. Sinha (2021) found the same trends in India, noting higher engagement in stock markets among financially literate citizens. Das and Roy (2022) explored the topic of digital finance, showing that fintech platforms usage increased investing behaviour among the financially literate. Agarwal (2017) summarized all findings by stating that a comprehensive approach embracing all dimensions of financial planning is vital for the welfare of the middle class.

Thus, all literature shows a recurrent tendency towards awareness of financial planning ideas and lack of consistent performance. The existing literature also addresses the dimensions of financial planning one at a time. To fill the gap in knowledge, the present study analyzes all major dimensions of financial planning concurrently.

III. THEORETICAL FRAMEWORK

The study is based on six theoretical frameworks. The Life Cycle Hypothesis (Modigliani & Brumberg, 1954) suggests that people equalise their lifetime consumption by saving during their working period and spending in their retired life. This framework provides an excellent foundation for budgeting and saving for retirement but is often disrupted due to income fluctuation in reality. According to the Permanent Income Theory proposed by Friedman (1957), middle-class families borrow money to purchase homes and fund educational costs in expectation of increased income in the future, justifying inadequate saving at the moment.

The Behavioural Finance Theory shows that people do not make optimal financial decisions, which are affected by present bias, social pressure, overconfidence, and emotional issues. It explains excessive spending, delayed insurance purchases, and last-minute investment in taxes even though people know better. Risk Management Theory justifies the use of insurance for planning by transferring financial risks from unknown sources to organisations capable of bearing

them, but middle-class families' inadequate insurance coverage highlights the practical limitation of this theory. The Theory of Planned Behaviour by Ajzen (1991) shows that individual financial activities depend on attitudes, subjective norms, and perceived control over their behaviour, especially when influenced by family members and peers. Lastly, the Financial Literacy Theory suggests that people with adequate knowledge about finance make superior investment and tax decisions compared to those who lack such information.

IV. RESEARCH METHODOLOGY

4.1 Research Design and Scope

Research design for this study will include descriptive and analytical methods. The population to be considered in this study includes middle-level urban and semi-urban people. This research will investigate four aspects of financial planning, including budgeting, loan management, insurance planning, and tax planning. Additionally, financial literacy will be used as a moderating factor to assess financial decisions making.

4.2 Data Collection

The primary data was obtained through the use of a structured Google Form survey that involved middle-class earning individuals using convenient and random sampling. This included various questions using different scales like the Likert scale, multiple-choice, and closed questions regarding: the budgeting behavior on a monthly basis, savings behavior, loans and EMI payments, knowledge about insurance and adequacy of coverage, taxation policies, financial literacy level, and financial management problems.

4.3 Sample

A total of 286 valid responses were obtained. Table 1 summarises the demographic profile of respondents.

Table.1. Demographic Profile of Respondents (n = 286)

Variable	Category	n	%
Age	Below 20	51	17.8%
	20–30	105	36.7%
	31–40	48	16.8%
	41–50	35	12.2%
	Above 50	47	16.4%
Gender	Male	123	43.0%
	Female	86	30.1%
	Prefer not to say	77	26.9%

4.4 Hypotheses

Six hypotheses were formulated and tested:

- H₁: Budgeting practices are significantly related to savings level.
- H₂: High loan/EMI burden has a significant negative impact on financial stability.
- H₃: Insurance awareness is significantly related to adequacy of risk coverage.
- H₄: Tax planning behaviour significantly influences investment decisions.
- H₅: Financial literacy is significantly related to effective financial decision-making.
- H₆: Absence of structured financial planning leads to financial stress.

4.5 Statistical Methods

Data were analysed using descriptive statistics (frequency distributions and percentages), chi-square tests of independence for categorical relationships (H₁, H₃, H₄, H₆), and Pearson correlation for continuous variable relationships (H₂, H₅). A significance threshold of $\alpha = 0.05$ was applied throughout.

V. RESULTS

5.1 Descriptive Findings

Table 2 presents the key descriptive statistics across the five financial planning dimensions.

Table.2. Key Descriptive Statistics by Financial Planning Dimension

Dimension	Key Finding	Frequency / %
Budgeting	Prepare monthly budget	159 / 55.6%
	No formal budget	127 / 44.4%
Savings	Save 10–20% of income	95 / 33.2%
	Save less than 10%	73 / 25.5%
	Save more than 20%	65 / 22.7%
	Do not save at all	53 / 18.5%
Loan Dependency	Have active loans	153 / 53.5%
	No active loans	133 / 46.5%
Insurance	Hold insurance primarily for tax saving	Majority
Tax Planning	Plan taxes reactively (year-end)	Majority

However, a two-way split in saving culture is clear since 33.2% save an average amount between 10%-20% while another 44% save below 10%. More than half (53.5%) have loans that they currently pay back. The use of insurance policies is common but is tax driven, and the planning is mainly reactionary rather than goal-oriented.

5.2 Hypothesis Testing

Table 3 summarises the inferential test outcomes for all six hypotheses.

Table.3. Summary of Hypothesis Testing Results

H	Hypothesis	Test	p-value	Decision
H ₁	Budgeting → Savings	Chi-square	0.317	Fail to reject H ₀
H ₂	EMI burden → Financial stability	Pearson r = -0.069	0.242	Fail to reject H ₀
H ₃	Insurance awareness → Coverage adequacy	Chi-square	< 0.05	Reject H ₀ ✓
H ₄	Tax planning → Investment decisions	Chi-square	< 0.05	Reject H ₀ ✓
H ₅	Financial literacy → Decision quality	Pearson r (positive)	< 0.05	Reject H ₀ ✓
H ₆	Lack of planning → Financial stress	Chi-square	< 0.05	Reject H ₀ ✓

H₁ — Budgeting vs. Savings: The result of a chi-square test showed that $p > 0.05$; $\chi^2 = 3.531$, $df = 3$, so there was insufficient evidence to reject the null hypothesis. In other words, it is evident that the act of developing a budget by itself does not allow making any conclusion about better financial outcomes related to savings. It follows that budget creation without discipline produces no benefits.

H₂ — EMI Burden vs. Financial Stability: Pearson correlation between the share of income allocated to EMIs and the perceived decrease in ability to save money demonstrated $r = -0.069$; $p = 0.242$. Hence, the null hypothesis should be retained. Although the negative direction is expected, the poor strength of the relation implies that the surveyed individuals tend to treat EMI differently when comparing to general savings habits.

H₃ — Insurance Awareness vs. Coverage Adequacy: Chi-square test proved that the p-value was less than 0.05 and, therefore, the null hypothesis had to be rejected. There is a strong significant connection between insurance knowledge and perceived adequacy. However, according to descriptive statistics, the correlation can be explained by the use of insurance products for tax benefits purposes only.

H₄ — Tax Planning vs. Investment: Chi-square test proved the presence of a statistically significant relationship between tax planning and choice of investment tools. As hypothesised, those who engage in proactive tax planning have a more structured attitude to investments, suggesting the impact of tax planning on investment behaviour.

H₅ — Financial Literacy vs. Decision Making: The Pearson coefficient was positive and greater than 0.05. As such, there was a statistically significant relationship between two variables, which means that the null hypothesis has been rejected. As shown, financial literacy was found to be positively correlated with decision-making but not a decisive factor.

H₆ — Lack of Planning vs. Financial Stress: A chi-square test confirmed the presence of a statistically significant relationship between the lack of planning and financial stress among respondents. Households that did not have a formal mechanism to organise finances were found to experience more financial problems.

VI. DISCUSSION

As a whole, the results can be said to point towards a paradox of planning and implementation when it comes to middle income families: knowledge regarding planning is widespread, but disciplined implementation still eludes. For example, the failure of budgets to predict saving outcomes (H₁) is remarkable in light of the near universal consensus in both academia and practice regarding budgeting being central to effective personal finance management. These results resonate with those of Joseph & Varghese (2020), who credited lifestyle inflation and impulse purchase as factors causing the same effect.

The lack of correlation between EMI and saving ability (H₂) points towards a likely scenario where middle income people perceive the cost of debt repayment as a fixed one rather than an obstacle to saving. Such cognitive approach aligns with Behavioural Finance Theory. It can thus be understood why middle income households continue acquiring new debt even though the amount of overall debt objectively reduces the ability to save money. Singh and Bansal (2021) and Mehta (2020) identified similar effects.

The results regarding insurance reflect fundamental contradictions existing between the nature of products and the behaviour of consumers. Insurance policies are obtained mostly to evade taxation (see Rao & Mishra, 2017; Kulkarni, 2019); not so much for mitigating risks associated with financial losses. The significant correlation noted in H₃ result indicates that awareness can indeed influence policy decisions, although a tax-based motivation behind purchasing insurance implies that coverage will be structured in accordance with tax requirements.

Tax planning and financial literacy proved to be the two most important variables influencing good financial practices. Significant correlations obtained in H₄ replicate the results of Chatterjee (2020) and Nair (2016); the H₅ result concurs with those of Lusardi & Mitchell (2014) and Sinha (2021). Notably, the correlation obtained in H₅ is in line with the majority of Behavioural Finance theory, suggesting that mere knowledge is not sufficient to ensure good financial habits. Psychological and social factors must also be taken into account.

Financial institutions can create financial products designed to facilitate savings and instill financial discipline: automatic deposits with mandatory debiting, income-based EMIs, insurance-investments bundles. Insurers should focus on marketing their products as solutions to mitigate financial risks. Policymakers could incorporate financial literacy lessons at schools and universities, and launch targeted programs for adults working in enterprises. Fintech companies

can help overcome the planning-implementation divide by developing budgeting and investment software. Workplace financial wellness programs could be implemented by organizations.

VII. CONCLUSION

The study highlights the importance of financial planning in the personal finance management of middle-income families in India, drawing on 286 respondents' data across five categories: budgeting, savings, loan management, insurance planning, and tax planning. The findings indicate that financial planning plays an important role in the financial stability of middle-income families, yet there still remains an existing gap between financial planning awareness and financial planning practice.

Some important findings include: (i) financial planning through budgeting does not necessarily lead to better savings unless strict adherence is ensured; (ii) dependency on loans is high, with over half of the sample population having at least one outstanding obligation, yet the full consequences remain unclear; (iii) insurance products are popular among Indian households but for tax reasons rather than for risk protection; (iv) tax planning is reactive, thus failing to seize opportunities for creating sustainable wealth; and (v) financial literacy emerges as the best indicator of good financial practices, despite its limited predictive power due to the lack of adherence and discipline.

In order for middle-income families to maintain financial security in the long term, a multi-faceted and multi-stakeholder approach is necessary: individuals need to shift their focus from preparing budgets to sticking to them; financial institutions and fintech firms should develop tools to facilitate planning; insurers need to sensitize clients to prioritize protection; and governments should make financial literacy part of school curriculums. In future studies, several recommendations can be drawn in relation to the present limitations, including convenience sampling, cross-sectional design, and regional bias in the urban area.

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