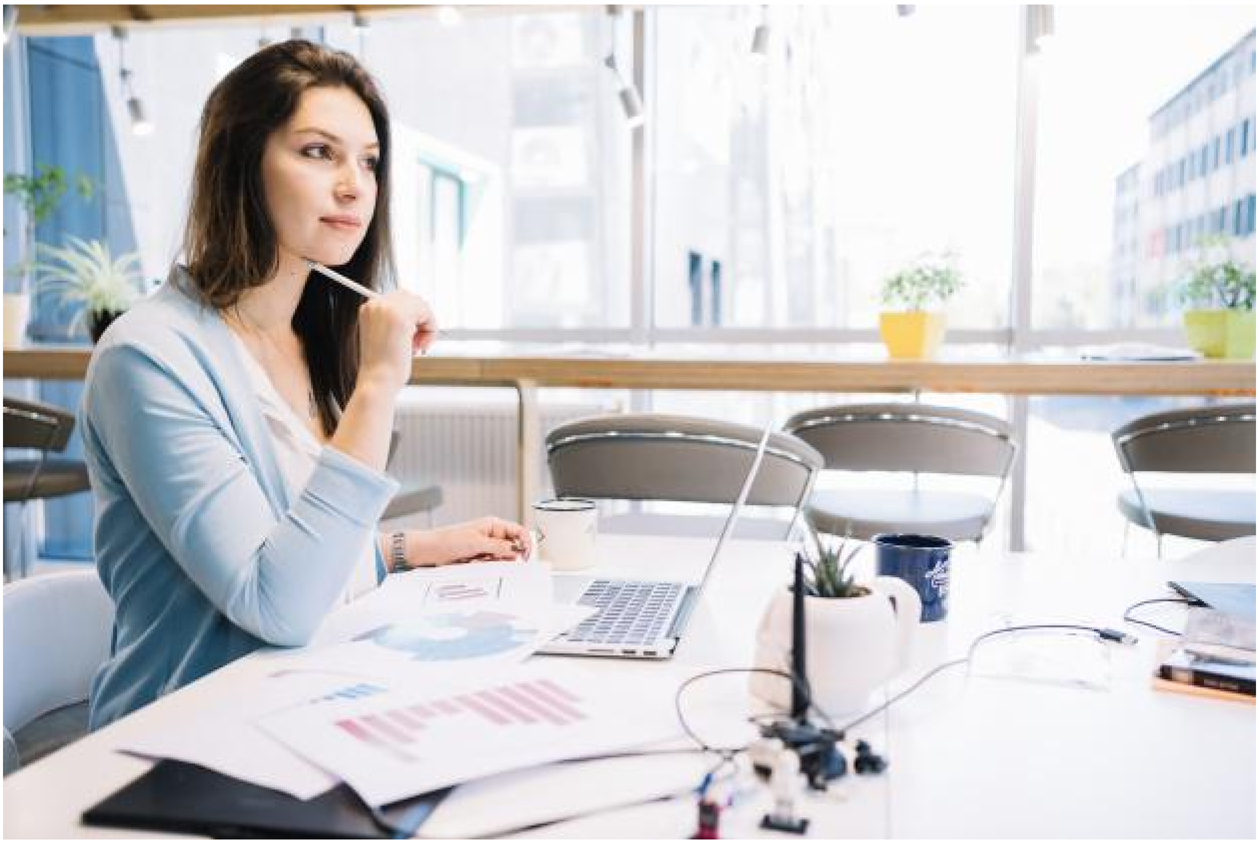
VG Siddhartha: Money lessons for you in death, as in life.

Managing debt, keeping personal and business finances separate, and curbing reckless spending are critical



The death of VG Siddhartha, the founder of India's largest coffee chain, Café Coffee Day (CCD), is most unfortunate. While there are debates on the business, tax and personal reasons behind his death, there are many lessons and action-points from the tragic story for investors. Managing debt, keeping personal and business finances separate, curbing reckless spending, keeping family members in the know and taking sufficient insurance are critical factors for the self-employed, business persons and in general for indebted people. Taking major loans from friends and family members is also best avoided.

The coffee king raised too much debt, especially in the last few years. CCD's debt started mounting and, by 2018, it stood at about Rs 3,300 crore. But the more disturbing aspect is that Siddhartha reportedly had huge personal debt of about Rs 1,000 crore.

Such cases of liabilities being passed on to the spouse and children are not all too uncommon. But, are legal heirs liable to pay for deceased person's debt? This aspect is explained later in this article.

Take stock of outstanding debt

Make a list of all your loans and the amounts that need to be repaid, as well as total assets available singly or jointly with your spouse or other family members.

Says Vishal Dhawan, certified financial planner, and founder Plan Ahead Wealth Advisors, "A family should adopt a process of maintaining a record of investments and total outstanding debts. Also, your spouse should be aware of the complete financial picture. It's much easier to figure out the details when they are needed in such unfortunate situations."

The assets would possibly need to be liquidated in order to repay the outstanding debt. If the loan was taken jointly, the onus to repay would automatically lie with the co-borrower. Even if the co-borrower is not the family member, the bank recovers the outstanding loan from the person.

What if there is no co-borrower? Financial advisor Nitin Bhatia makes an important point: "In the absence of a co-borrower, the bank approaches legal heirs to settle the outstanding loan. In case the loan is not settled by legal heirs, then the banks may take physical possession of the assets such as house, car and auction the same to recover their outstanding debt."

In short, the person may pass way, but loans taken will need to be repaid.

Separate family affairs from those of the business

Most self-employed people don't separate personal and business liabilities. An EMI on loans for business is paid from one's savings account. Also, they do not track business and household expenses every month. Tarun Birani, founder and CEO of TBNG Capital Advisors says, “Make it a point to segregate your personal and business expenses. Also, start withdrawing salary from your business income and treat it like any other business expense every month. Your lifestyle and other monthly expenses should be limited to this income you get home every month.” Such a practice will help you stay organised with your financials and you will stay safe from a debt trap.

Avoid debt to buy depreciating assets

All products that you buy with loans that depreciate over time are considered bad loans. You will never recover the sum plus interest paid on them; for example, shopping for clothes, mobiles, and consumer electronics via a consumer durable loan or buying a car on car loan. Sukanya Kumar, Founder & Director of home loan advisory firm, RetailLending.com says, “The moment you walk out of the shop, it depreciates by 30-50 per cent at least. It becomes a 'second-hand' item.”

A loan which enhances the worth of the purchased product over time and gives returns over the period, absorbing the interest cost attached to it can be considered a good loan. Kumar says, “A home purchased on loan appreciates in price in the long term, if bought wisely after thorough research in a good location and will succeed in recovering the interest cost too.” The added advantage of taking a home loan is also the tax benefit under a couple of sections from in the income tax act.

Make sure your debt is in control and your total loan EMI does not exceed 35-40 per cent of your monthly income.

Understand how major liabilities are repaid

Home loans

As mentioned earlier, in case a home loan were taken singly and the person dies, the bank will auction the property and the proceeds will go towards repayment of the outstanding amount.

In the case of joint loans taken with a spouse or a family member, this liability of repaying the home loan falls on the surviving spouse or the family member as per the loan agreement.

There is this advice from Sukanya: “If you are unable to repay the outstanding home loan, consult the lenders. They may agree to change the loan terms and increase the loan tenure, reduce monthly installments or give you a holiday from EMIs for three to six months to take control of your finances. You can then begin the repayment.”

Unsecured loans

Personal loans and credit card debt are unsecured loans. Banks have a right to claim all outstanding amounts from legal heirs of the deceased in such cases. You may have to approach banks and settle these outstanding dues immediately. In unsecured loans, the dues may increase with accumulated interest, which is much higher compared to what is paid on secured debt. Mrin Agarwal, financial educator and founder of Finsafe India explains the way forward, “The banks can file a civil suit against the heirs for the recovery of their funds. In such cases, the heirs may consult an advocate to safeguard their interests.” If no mutual settlement is reached with the bank, the legal procedures may turn in favor of the bank, with the legal heir having to settle the outstanding debt.

Business loans

In case of the death of a person who owns a business that is a sole proprietorship, that is a single owner, the banks still auction assets to recover their dues. Arvind Rao, a Mumbai-based financial advisor and founder of Arvind Rao and Associates says, “When the sole proprietor dies, the business operations are terminated and outstanding debt is first cleared by selling off business assets and then from personal assets as required.”

If the business runs as a partnership firm or as a private company, the bank agreement will have other partners or directors of the company signings it as co-borrowers. So, in case of the sudden demise of a person who has taken loans for the business and the company or partnership firm is unable to repay the outstanding debt, the other partners or directors will have to pay the dues. The full liability is transferred to them.

Entrepreneurship is filled with risks. The entrepreneur must develop an ability to segregate his personal and business lives. Caution has to be exercised while borrowing for business purposes, so that the family doesn’t have to suffer in case of a sudden demise.

Prepare a will and update it regularly

Financial advisors recommend having a will prepared while taking a loan. It serves two purposes, says Dhawan.

It lists out all the assets that a person has. In case of his demise, the family knows what assets he owned, so that if they need to repay any pending loans by liquidating any assets, they would now know which assets to liquidate and where those assets are kept.

Secondly, the person can also put down a guidance in his will as to what assets should be liquidated to repay loans, if any, in case the person dies. "In many Indian families, the male member of the house manages the finances. Often, when he passes away, the spouse and the rest of the family are clueless as to what to do of the finances. On top of it, if they inherit a loan, it could get tricky. A will helps in such matters", says Dhawan.

It is important to mention in the will as to who would settle the liabilities after the borrower’s death.

Take a term plan policy to cover all loans

Often, individuals ignore the term life insurance cover for loans. Kumar says, “They consider it as an additional expense and prefer taking risks by ignoring this life insurance cover. There can be instances wherein borrowers don’t plan for repayment of loans and in case of a sudden demise, the liability falls on the legal heir.”

Often, many of us think that an insurance cover bought long ago would be enough to repay the debts in case we pass on. However, in reality, the older insurance covers would be just about enough to cover the loss of breadwinner's income, and not any debt undertaken by him in his lifetime, that would now need to be paid.

Bhatia advices, "You should always keep your insurance needs separate from the cover required to hedge debts and loans." For instance, if you already have a life insurance cover of Rs 2 crore considering family goals and have availed a home loan of Rs 1 crore recently, you should buy a separate life cover of Rs 1 crore to hedge the home loan risk.

Keep your spouse in the know about finances

Often, one family member looks after money matters and plans for goals. The spouse and children are unaware of the investments and liabilities on the family. There are instances wherein family members are not aware about bank account details and investments after the demise of the person who looked after the money matters.

Agarwal says, "Keep your spouse in the loop on assets and liabilities of the family. You should inform her about new loans taken, outstanding loans, because, in future she may have to manage in case of untimely demise."

It should not be limited to knowing your assets and liabilities. You should also share passwords to access investments and net banking for all accounts. Dhawan says, "In case of sudden demise, your spouse needs to be aware of all the passwords. Also, ensure that they are secure. Often, it happens that the spouse may keep the same password for all sites it creates a security threat in the future."