

What is Financial Security?

by Michael Mihalik

Wouldn't it be great to be financially secure—to never have to worry about money?

What would it take to get there? In fact, what exactly is financial security?

Ask 10 people to define how much money it takes to attain financial security and you will probably get 10 different answers. For some people, financial security is having \$10 million in the bank. For others, it's \$50 million.

I doubt anybody would say \$1 million. Being a uni-millionaire isn't what it used to be. With the median home price in the United States around \$220,000 (the median price in my hometown, Seattle, is pushing \$425,000), there may not be much left after paying off the mortgage. Even having the full million in the bank earning 5% per year will only produce an income of \$50,000 per year. That's not bad, but not enough to jet around the world and party with Paris Hilton, Mick Jagger, and Diddy.

What about \$10 million? At 5%, that will generate an annual income of \$500,000—without working. Now we're talking some real money!

The problem with defining financial security in these terms is that having \$10 million, \$50 million or even \$1 million is a pie-in-the-sky dream for most Americans. We'd all like to have millions of dollars, and it's not bad to aspire to that goal. The problem is, if we define financial security by such large amounts of money, most of us will believe that it's out of our grasp. Instead, we should use a realistic definition of financial security that can be achieved whether somebody makes \$10,000 a year or \$1,000,000.

First, let's look at what financial security is not.

Financial security isn't making or having a certain amount of money. There are many people who have made millions of dollars who are not financially secure. Stories about musicians, superstar athletes and multi-million-dollar lottery winners who end up in bankruptcy court are so common that they've become a cliché. If someone makes \$500,000 a year, but spends \$600,000, are they financially secure? Of course not.

Financial security also isn't limited to being independently wealthy, having servants bring you martinis by the pool, and flying your private jet to Monaco to party with heiresses, super-models, and rock stars. If that's what you want, then go for it, but this is a very narrow definition of financial security.

I prefer a broader definition, one that puts financial security within the reach of anybody with a desire to improve their financial situation, and a little bit of discipline.

To me, financial security consists of 4 things:

1) Being debt-free

Consider two women:

Jill:

Makes \$35,000 a year.

Has \$250 in her savings account.

Owes \$10,000 on her credit cards.

Joan:

Makes \$35,000 a year.

Has \$10,000 in her savings account.

Owes \$250 on her credit cards.

Which woman do you think feels financially secure? Which sleeps better at night?

Certain debt is understandable. Few people have the money to write a check for a car or a house. Borrowing money for an education or to start a business may also be acceptable, but borrowing money for other reasons is probably a mistake.

How many of you are still paying off the credit card debt for:

- The vacation you took last summer?
- The elegant, romantic Valentine's Day dinner last February?
- The pair of expensive Italian shoes you just gave to Goodwill?
- Christmas presents your kids no longer play with?
- Electronic equipment that has since become obsolete?

When you owe somebody money, they have power over you. You go to work, even if you don't want to, because you have to pay back your debt. If you don't pay, you can be sued, your car can be repossessed, or your house can go into foreclosure. That doesn't sound like security to me.

2) Being in control of your expenses

As I mentioned earlier, if you earn \$500,000 a year, but you're spending \$600,000, you're on your way to the poorhouse. If you control your expenses so that they are less than your income, you can save and invest the extra money, and you're on your way to becoming financially secure.

3) Consistently increasing your savings/assets/net worth on a monthly basis

Most people have little to show for years or even decades of hard work. For whatever reason, they can't or won't save money and they're one paycheck away from being destitute.

We should focus on saving money every month. It's a great feeling to watch your savings grow, especially because the interest compounds without any extra effort from you. Instead of you working for money, your money can work for you.

4) Not being forced to work at a job you dislike just to pay the bills

Many people live paycheck-to-paycheck and are stuck at jobs they don't enjoy because they have to pay their bills. If they quit their jobs or were laid off, it wouldn't take long before they were in dire financial trouble.

If you are debt-free, control your expenses, and focus on increasing your savings on a monthly basis, you can survive tough times, such as a layoff, for months, or even years, without a change in your lifestyle. You will also have the freedom to quit a job you don't like and take your time finding a new job, preferably one that you will enjoy.

Financial security is an admirable goal for which we should all strive. However, it's important to define financial security so that it is achievable for the average American. Being debt-free, controlling our expenses, increasing our savings every month, and doing what we love can lead to happy, fulfilling, and prosperous lives for us all.