framework financial

latest word

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Fundamentals of Financial Success (Part 2)

"Money is better than poverty, if only for financial reasons." Woody Allen

In the last newsletter, we spoke about that first fundamental aspect of financial success; your earnings. We spoke about how what you earn is a direct result of how you serve. We spoke about using leverage to serve more to earn more. So earning money is essentially an exchange, it's a measure of value, you earn it by exchanging a product or service in exchange for money. So to earn, and earn more, fundamentally you have to provide more value to more people.

Spend or Save

The second fundamental component of financial success is Spending and Saving.

You'll never attain financial success if you spend all that you earn. Sounds silly, doesn't it. Yet how do so many people desire financial success and yet spend all that they earn?

Many of us are familiar with the experience of that first proper job, and for the first time having disposal income and most likely little or no real outgoings. Initially, it's likely they may not spend it all and save some but before long have brought their outgoings right up to their income level thereby consistently spending all that they earn. Maybe even taking out a loan to spend more than they have currently earned and commit future income to paying it back.

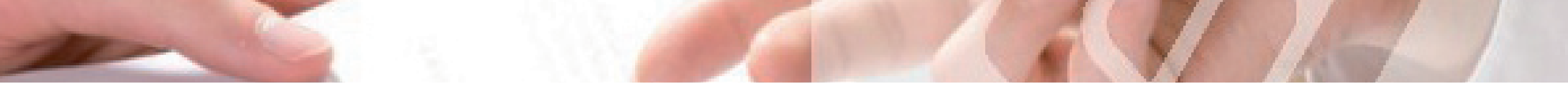
Then maybe through a job promotion or change of job, the income takes a jump, and for a lot of people the pattern is to raise the outgoings to match that increased income resulting in full spending of all earnings.

If you spend all you earn, you'll never achieve financial success and are always exposed to the risks of a fall in income. Most people will have committed outgoings such as loans and therefore are pretty immediately exposed to money problems as soon as their income falls or indeed stops. So for many people, they are only a pay cheque or two away from being insolvent.

Now we have not even got started on credit, otherwise known as *"spending what you have not got"*. Now borrowing money makes a lot of sense in many ways such as a mortgage. You need somewhere to live, and you have to live somewhere while you are saving money to buy a house, so it's perfect sense to borrow the money now and live in the house while you are still saving (& paying) for it. Interest is the price you pay for this convenience.

Credit cards in their purest form are a very effective form of convenience if used correctly, and even using them for short term cash flow while earnings and spending temporarily don't match, is reasonable but for most people is that how they are really used?

Credit is about spending today what you expect/hope to earn tomorrow. It's inherently risky. If your earnings/income are not rising you are effectively



reducing your disposable income in the future so you can have it now.

Let's consider an untidy teenager for a second and a parent attempting motivation;

"I'll buy you tickets for that movie you're dying to see, if you tidy your bedroom after you come home"
or
"If you tidy you're room quickly, I'll buy you tickets for that movie you are dying to see "

What would you think is the most effective strategy? Is there a difference in the quality of the incentive when it comes before or after the reward?

Now do you think fully grown adults differ that much from teenagers in this regard?

"I want it now and I'll pay for it later" or "I'll worry about paying for it later, my circumstances will surely be different then". Even governments love to do it.

Is this an unfair description of human behaviour? Why are so many people putting off/not planning their future income through savings/investments/pensions? Have they honestly considered what are they going to live off when they are too old to earn in the way they may be doing today? Are they expecting the government to provide the solution? What's the track record of governments (pretty much anywhere) to provide solutions to meet citizen's expectations? Have they considered any actual numbers and thought about the real quality of life implications when you're living off a lot less money? How much of a role does 'Hope' play? I'm all for hope but it's not often a good substitute for action and you can't buy milk and bread with it?

So let's say financial success is loosely defined as having enough money for today, tomorrow and in unforeseen circumstances so you can rest easy and sleep at night. If you spend all that you earn (& more), financial success will remain a hope rather than a reality.

That Warren Buffett fellow, who seems to know a thing or two about money and financial success has some interesting insights on spending and saving. He says;

On Spending - *"If you buy things you do not need, soon you will have to sell things you need."*

On Saving - *"Do not save what is left after spending, but spend what is left after saving."*

That quote on saving is the key mindset difference.

There is a personal finance concept called "Paying yourself first" which is essentially this idea. Save first, spend what's left after saving. The idea would be to make savings an automated process, so that the money goes directly to savings (via direct debit, standing order or equivalent) so that you avoid the temptation to spend it.

You may not have really got or bought into that concept to date but please, please, please teach it to your children.

So the first fundamental component of financial success was Earning, and that's the second fundamental component of financial success, Spending & Saving.

Our next newsletter will cover the next piece of the jigsaw. It's not at all difficult, it's more of a mindset change that is required. Spend after saving, not the other way around.

As ever, we are here to help, just call us.

Last word

Thanks for taking the time to read our "latest word"

Feedback on our newsletters is always welcome and gratefully received. joe@fwf.ie.

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