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# Financial Freedom or Independence

**Dr. Saurabh Verma**
Assistant Professor, Department of Commerce, Upadhi PG College, Pilibhit, Uttar Pradesh, India

**Abstract:** Financial independence is the status of having enough income or wealth sufficient to pay one's living expenses for the rest of one's life without having to be employed or dependent on others.[1] Income earned without having to work a job is commonly referred to as passive income. Others define financial independence differently according to their own goals.

There are many strategies to achieve financial independence, each with their own benefits and drawbacks. Someone who wishes to achieve financial independence can find it helpful to have a financial plan and budget, so that they have a clear view of their current incomes and expenses, and can identify and choose appropriate strategies to move towards their financial goals. A financial plan addresses every aspect of a person's finances.[2]

**Keywords:** financial, freedom, independence, income, budget, plan, expenses, goals.

## Introduction

The following is a non-exhaustive list of sources of passive income that potentially yield financial independence.

- ✓ Bank fixed deposits and monthly income schemes
- ✓ Business ownership (if the business does not require active operation)
- ✓ Dividends from stocks, bonds and income trusts
- ✓ Interest earned from deposit accounts, money market accounts or loans
- ✓ Life annuity
- ✓ Notes, including stocks and bonds
- ✓ Oil leases
- ✓ Patent licensing
- ✓ Pensions
- ✓ Rental property
- ✓ Royalty from creative works, e.g. photographs, books, patents, music, etc.
- ✓ Trust deed (real estate)

If a person can generate enough income to meet their needs from sources other than their primary occupation, they have achieved financial independence, regardless of age, existing wealth, or current salary. For example, if a 25-year-old has $1000 in expenses per month, and assets that generate $1000 or more per month, they have achieved financial independence. They have no need to work a regular job to pay their bills.

On the other hand, if a 50-year-old has assets that generate $1,000,000 a month but has expenses that equal more than that per month, they are not financially independent, as they still have to earn the difference each month to make all their payments.

However, the effects of inflation must be considered. If a person needs $100/month for living expenses today, they will need $105/month next year and $110.25/month the following year to support the same lifestyle, assuming a 5% annual inflation rate. Therefore, if the person in the above example obtains their passive income from a perpetuity, there will be a time when they lose their financial independence because of inflation.

If someone receives $5000 in dividends from stocks they own, but their expenses total $4000, they can live on their dividend income because it pays for all their expenses to live (with some left over). Under these circumstances, a person is financially independent. A person's assets and liabilities are an important factor in determining if they have achieved financial independence. An asset is anything of value that can be readily turned into cash (liquidated) if a person has to pay debt, whereas a liability is a responsibility to provide compensation. (Homes and automobiles with no loans or mortgages are common assets.)

Since there are two sides to the assets and expenses equation, there are two main directions one can focus their energy: accumulating assets or reducing their expenses.

Accumulating assets can focus one or both of these approaches:

- Gather revenue-generating assets until the generated revenue surpasses living/liability expenses.
- Gather enough liquid assets to then sustain all future living/liability expenses.

Another approach to financial independence is to reduce regular expenses while accumulating assets, to reduce the amount of assets required for financial independence. This can be done by focusing on simple living, or other strategies to reduce expenses.[3][4]

**Discussion**

The FIRE (Financial Independence, Retire Early) movement is a lifestyle movement with the goal of gaining financial independence and retiring early. The model became particularly popular among millennials in the 2010s, gaining traction through online communities via information shared in blogs, podcasts, and online discussion forums.[1][2][3][4][5]

Those seeking to attain FIRE intentionally maximize their savings rate by finding ways to increase income and/or decrease expenses, along with aggressive investments that again increases their wealth and/or income. The objective is to accumulate assets until the resulting passive income provides enough money for living expenses throughout one's retirement years. Many proponents of the FIRE movement suggest the 4% rule as a rough withdrawal guideline, thus setting a goal of at least 25 times one's estimated annual living expenses. Upon reaching financial independence, paid work becomes optional, allowing for retirement from traditional work decades earlier than the standard retirement age.

FIRE is achieved through aggressive saving, far more than the standard 10–15% typically recommended by financial planners.[6] Assuming expenses are equal to income minus savings, and neglecting investment returns, observe that:

- At a savings rate of 10%, it takes (1-0.1)/0.1 = 9 years of work to save for 1 year of living expenses.

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- At a savings rate of 25%, it takes (1-0.25)/0.25 = 3 years of work to save for 1 year of living expenses.
- At a savings rate of 50%, it takes (1-0.5)/0.5 = 1 year of work to save for 1 year of living expenses.
- At a savings rate of 75%, it takes (1-0.75)/0.75 = 1/3 year = 4 months of work to save for 1 year of living expenses.

From this example, it can be concluded that the time to retirement decreases significantly as savings rate is increased. For this reason, those pursuing FIRE attempt to save 50% or more of their income.[7] At a 75% savings rate, it would take less than 10 years of work to accumulate 25 times the average annual living expenses suggested by 'the 4% safe withdrawal' rule.

There are also two sides to the spectrum of FIRE. Lean FIRE refers to the ability to retire early on a smaller accumulation of retirement income and limited living expenses which will require a frugal lifestyle during retirement. On the other end of this is Fat FIRE, which refers to the ability to retire early due to a large amount of accumulated wealth and passive income with no concerns about living expenses during retirement. A hybrid of these two is known as Barista FIRE, which refers to a semi-retired lifestyle of working part-time for some supplemental income, or retiring fully but with a partner who continues to work.

FIRE is viewed as a lifestyle, not simply an investment strategy. A common thread that challenges individuals that subscribe to the FIRE lifestyle is finding partners that share the same fiscal goals. Availability of online resources helps the movement to expand among Millennial high-net-worth individuals.[8][9][10]

The emergence of social media has brought more attention to worker's sharing about their dissatisfaction. "Social media has made lives appear more glorious and expensive, but also allows others to broadly share about their financial freedom." said Zachary A. Bachner, CFP(r) of Summit Financial.[11]

The main ideas behind the FIRE movement originate from the 1992 best-selling book Your Money or Your Life written by Vicki Robin and Joe Dominguez,[12][13] as well as the 2010 book Early Retirement Extreme by Jacob Lund Fisker.[14] These works provide the basic template of combining a lifestyle of simple living with income from investments to achieve financial independence. In particular, the latter book describes the relationship between savings rate and time to retirement, which allows individuals to quickly project their retirement date given an assumed level of income and expenses.

The Mr. Money Mustache blog, which started in 2011, is an influential voice that generated interest in the idea of achieving early retirement through frugality and helped popularize the FIRE movement.[15][16] Other books, blogs, and podcasts continue to refine and promote the FIRE concept.[17][18][19] A Notable contributor to this movement includes Financial Freedom author Grant Sabatier, who works closely with Vicki Robin and popularized the idea of side hustling as a path to accelerate financial independence.[20][21][22] In 2018, the FIRE movement received significant coverage by traditional mainstream media outlets.[7][12][13][15] According to a survey conducted by the Harris Poll later that year, 11% of wealthier Americans aged 45 and older have heard of the FIRE movement by name while another 26% are aware of the concept.[23]

2020 saw the introduction of dating sites and blogs dedicated to bringing partners that share the FIRE lifestyle together.[24]

Some critics allege that the FIRE movement "is only for the rich",[25] pointing to the difficulties of achieving the high savings rates needed for FIRE on a low income.[15] Another common criticism is that the FIRE movement is composed only of white "tech bros", a notion that highlights the fact that men are overrepresented in media coverage of the FIRE movement.[26] A New York Times story focused on the women and women of color in the FIRE movement. It highlighted Kiersten Saunders and called Tanja Hester, author of the book Work Optional, "the matriarch of the FIRE women."[27] Paula Pant, host of the Afford Anything podcast, and Jamila Souffrant, host of the Journey to Launch podcast, are also prominent women of color in the FIRE movement.[28][29] Some also argue that early retirees are not saving enough for early retirement and the many unknowns that come with a longer time period. Because the retirement phase of FIRE could potentially last 70 years, critics say that it is inappropriate to apply the 4% rule, which was developed for a traditional retirement timeframe of 30 years.[7] For that reason, Hester and economist Karsten Jeske argue for a safer withdrawal rate of 3.5% or less, which means saving 30-40 times one's annual spending instead of 25 times if the goal is to retire completely and never earn money again through employment (i.e. providing a service or product)[31]

**Results**

In general usage, a financial plan is a comprehensive evaluation of an individual's current pay and future financial state by using current known variables to predict future income, asset values and withdrawal plans.[1] This often includes a budget which organizes an individual's finances and sometimes includes a series of steps or specific goals for spending and saving in the future. This plan allocates future income to various types of expenses, such as rent or utilities, and also reserves some income for short-term and long-term savings. A financial plan is sometimes referred to as an investment plan, but in personal finance, a financial plan can focus on other specific areas such as risk management, estates, college, or retirement.[30]

In business, "financial forecast" or "financial plan" can also refer to an annual projection of income and expenses for a company, division, or department;[2] see Budget § Corporate budget. More specifically, a financial plan can also refer to the three primary financial statements (balance sheet, income statement, and cash flow statement) created within a business plan. A financial plan can also be an estimation of cash needs and a decision on how to raise the cash, such as through borrowing or issuing additional shares in a company.[3]

Note that the financial plan may then contain prospective financial statements, which are similar, but different, to those of a budget. Financial plans are the entire financial accounting overview of a company. Complete financial plans contain all periods and transaction types. It's a combination of the financial statements which independently only reflect a past, present, or future state of the company. Financial plans are the collection of the historical, present, and future financial statements; for example, a (historical & present) costly expense from an operational issue is normally presented prior to the issuance of the prospective financial statements which propose a solution to said operational issue.[32]

The confusion surrounding the term "financial plans" might stem from the fact that there are many types of financial statement reports. Individually, financial statements show either the past, present, or future financial results. More specifically, financial statements also only reflect the specific categories which are relevant. For instance, investing activities are not adequately displayed in a balance sheet. A financial plan is a combination of the individual financial statements and reflect all categories of transactions (operations & expenses & investing) over time.[35]

Some period-specific financial statement examples include pro forma statements (historical period) and prospective statements (current and future period). Compilations are a type of service which involves "presenting, in the form of financial statements, information that is the representation of management".[4] There are two types of "prospective financial statements": financial

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forecasts & financial projections and both relate to the current/future time period. Prospective financial statements are a time period-type of financial statement which may reflect the current/future financial status of a company using three main reports/financial statements: cash flow statement, income statement, and balance sheet. "Prospective financial statements are of two types- forecasts and projections. Forecasts are based on management's expected financial position, results of operations, and cash flows."[5] Pro Forma statements take previously recorded results, the historical financial data, and present a "what-if": "what-if" a transaction had happened sooner.[6]

While the common usage of the term "financial plan" often refers to a formal and defined series of steps or goals, there is some technical confusion about what the term "financial plan" actually means in the industry. For example, one of the industry's leading professional organizations, the Certified Financial Planner Board of Standards, lacks any definition for the term "financial plan" in its Standards of Professional Conduct publication. This publication outlines the professional financial planner's job, and explains the process of financial planning, but the term "financial plan" never appears in the publication's text.[7]

The accounting and finance industries have distinct responsibilities and roles. When the products of their work are combined, it produces a complete picture, a financial plan. A financial analyst studies the data and facts (regulations/standards), which are processed, recorded, and presented by accountants. Normally, finance personnel study the data results - meaning what has happened or what might happen - and propose a solution to an inefficiency. Investors and financial institutions must see both the issue and the solution to make an informed decision. Accountants and financial planners are both involved with presenting issues and resolving inefficiencies, so together, the results and explanation are provided in a financial plan.

Textbooks used in universities offering financial planning-related courses also generally do not define the term 'financial plan'. For example, Sid Mittra, Anandi P. Sahu, and Robert A Crane, authors of Practicing Financial Planning for Professionals[8] do not define what a financial plan is, but merely defer to the Certified Financial Planner Board of Standards' definition of 'financial planning'. When drafting a financial plan, the company should establish the planning horizon,[9] which is the time period of the plan, whether it be on a short-term (usually 12 months) or long-term (two to five years) basis. Also, the individual projects and investment proposals of each operational unit within the company should be totaled and treated as one large project. This process is called aggregation.[10]

**Conclusions**

Income is the consumption and saving opportunity gained by an entity within a specified timeframe, which is generally expressed in monetary terms.[1] Income is difficult to define conceptually and the definition may be different across fields.[2] For example, a person's income in an economic sense may be different from their income as defined by law.[2]

An extremely important definition of income is Haig–Simons income, which defines income as Consumption + Change in net worth and is widely used in economics.[2]

For households and individuals in the United States, income is defined by tax law as a sum that includes any wage, salary, profit, interest payment, rent, or other form of earnings received in a calendar year.[3] Discretionary income is often defined as gross income minus taxes and other deductions (e.g., mandatory pension contributions), and is widely used as a basis to compare the welfare of taxpayers.[33]

In the field of public economics, the concept may comprise the accumulation of both monetary and non-monetary consumption ability, with the former (monetary) being used as a proxy for total income.

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For a firm, gross income can be defined as sum of all revenue minus the cost of goods sold. Net income nets out expenses: net income equals revenue minus cost of goods sold, expenses, depreciation, interest, and taxes.[1]

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