``Whether you call it a financial cushion or an emergency fund, having extra money can help when you have unexpected expenses. Understanding how much of a financial cushion you need and how to build it, can help you decide how much you need to put away for your own financial protection. In this article, we will explore how much you need for your emergency fund, how to build one and how it can help you stay on top of your financial goals.

What is a Financial Cushion?

A financial cushion is a sum of money that you stash away to be used only during an emergency. Ideally, this fund should be separate from your regular savings and money used for other day-to-day expenses. A financial cushion or an emergency fund is an important component of a financial plan for the people who are serious about wealth creation. Benjamin Franklin summed it up quite nicely when he said "if you fail to plan, you are planning to fail".

Why Do I Need a Financial Cushion?

A lack of savings for emergency purposes often forces you to use your credit cards, deplete savings or take on loans to cover expenses that arise unexpectedly. Having to do this can derail you from the path of wealth creation. Additionally, these avenues can have catastrophic effects on your overall debt. Whether it is costs related to your car, major home repairs or covering living expenses during critical illness[1], unplanned expenses can become a real nightmare if you have no contingency plan. Therefore, it is wise to set aside money that is solely for these unforeseen circumstances.

For instance, if your motor vehicle unexpectedly breaks down and you do not have an emergency fund, then you may have one of two choices. You can use your savings to cover the cost or take on

[1] We recommend having insurance specifically for critical illness.

debt in the form of your credit card or a personal loan. Doing the latter would mean that you have either acquired new debt, or acquired more debt if you have existing debt. If you borrow, you will likely be saving less because you now have payments to make on your newly acquired debt. You can avoid these scenarios if you establish a financial cushion that allows you to cover these unexpected costs.

In extreme circumstances, having a financial cushion is a real asset. If you are serious about building wealth, an emergency fund should form a critical part of this strategy. Having an emergency fund ensures that you can maintain your saving and investment plans, even if you are faced with unanticipated expenses. In a nutshell, the benefits of having an emergency fund include having better control over when and why you take on debt, the peace of mind that comes from knowing that there is money available should the need arise, and your ability to remain focused on your financial goals even in the face of unplanned expenses.

How much is an Adequate Cushion?

Your current financial situation has to be considered when deciding how much you need in your emergency fund as it determines the amount of your expenses and your ability to save. As a starting point, it would be good to work through a few "unexpected expense" scenarios to see how much funds would be required in each. This exercise will allow you to estimate just how much you may need to save. As a starting point, we recommend that you accumulate at least 3 months' salary. However, as time progresses, increase that amount to at least 6 months' salary.

How to Build Your Emergency Fund

Three months' salary might seem like a lot of money to save all at once, but, don't panic, here is a step-by-step approach to accumulate this amount. The first thing you must decide is *"where will you keep your emergency funds?"*. The best option may be to save your emergency funds in a high-yielding savings account, separate from the regular savings accounts, where you can earn interest rates that are higher than that received on a traditional savings account. Now, having decided on the where, you can now focus on *"how will you build your emergency fund?"*. The most important rule of building your emergency fund is to first decide on how much you would be willing and able to contribute to the fund on a monthly basis. Having knowledge of what the monthly contribution would be, allows you to determine the length of time it will take to amass the desired sum. You can also put small windfalls into your emergency fund. Finally, *"how do you ensure that you meet your monthly target?"* Ensure that you automate your financial cushion. To guarantee self-discipline in building up the emergency fund, ensure that there is an immediate automatic transfer of the monthly sum to your emergency fund account from your monthly salary. This ensures that contributions are consistent and your money is funneled exactly where it needs to go, bringing you closer to the target fund balance.

What have we learnt? To sum up, an emergency fund is money that you hold for unplanned expenses. By establishing an emergency fund, you will eliminate the need to rely on credit cards, deplete savings or acquire loans to navigate unforeseen financial situations. More importantly, it allows you to stay focused on your financial goals in these circumstances. As a starting point, aim to accumulate at least three months' salary for your emergency fund, and overtime, try to raise that amount to at least 6 months' salary. Remember, preparation forms an integral part of your financial success, and as Confucius rightly said, "Success depends upon previous preparation, and without such preparation there is sure to be failure."