What Are Your Personal Financial Ratios?

By Gary Case

In the business world, ratios such as price-to-earnings, price-to-book-value, and dividend yield are often used to help determine the financial health of a company. One challenge in personal financial planning is that there are no generally accepted ratios comparable to the company ratios described above. However, Charles J. Ferrell, a financial planner in Medina, Ohio, has established what he calls Personal Financial Ratios that individuals can use to evaluate their personal financial circumstances. The ratios are designed as a roadmap to help answer the question, "How much should I save for retirement?"

Just as business ratios are based on a company's earnings, personal financial ratios are based on a family's income. Assumptions underlying the ratios include household budgets, the amount of income that needs to be replaced during retirement, rates of return (both before and after retirement), and retirement account distribution rates.

Personal ratios do not tell the entire story of your economic health. They are not a substitute for professional advice, nor do they account for all of the variations in people's financial lives. But they do serve as a tool, a guideline to help convey how a family's income, savings, and debt are related, and how the relationship between them must change over time to maintain financial health.

The three personal financial ratios I will discuss in the next few columns are:

- Savings-to-Income (the relationship of your retirement savings account balance to your annual income)
- Debt-to-Income (how much total debt you have compared to your annual income)
- Savings Rate-to Income (what percentage of your annual income are you saving)

Using the ratios can help individuals and couples move from a situation of high debt and low savings account balances early in their working careers to one of high account balances and no debt by the time they retire. Proper budgeting and a disciplined savings program are key to a family's financial success. Unfortunately, discipline cannot be packaged and sold; it must be developed and honed throughout a financial lifetime. Your financial planner can assist you in this pursuit by helping you apply personal financial ratios to your unique situation, working together with you to move towards your personal financial goals.

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