When I was in my 20s, I made a decision that my now 42-year-old self is really grateful for: I started to save early in my employer savings 401(k) plan. Believe me, it wasn't always easy. I wasn't making that much money, but I decided to put 10% of my annual salary in the plan. And I stuck with it. The result? I have more money in my pocket to spend today, and I am on track for my long-term goals.

It's so easy to delay saving when you're just starting out. Life comes up. I get that. But look at it this way: Because I got a head start, I have more flexibility and discretionary funds now to make lifestyle choices like memberships to clubs, travel, and maybe a higher-end car. I don't have to play catch-up and put 30% or more of my income toward retirement savings.

I started out in the financial services business, so I'd learned about savings plans like 401(k)s early on. You've probably heard of them too, and chances are your employer may offer one. You might even be automatically enrolled. But having a 401(k) and making the most of it are two different things. Here's what you need to know.

What is a 401(k), and why should you care?

In your 20s, you're probably not thinking much about retirement. When 401(k)s are presented as a *retirement* plan, a lot of young people feel that can wait. That's why I'd rather think of a 401(k) as an employer *savings* plan that makes it easy and automatic to save more now. Here's how it works:

- You enroll in your employer plan and decide how much of your salary you want to contribute each year. Let's say you make $40,000 and you decide, like I did, to save 10%. That's $4,000 a year! The money is taken out of your paycheck automatically each month and put in your plan. Eventually you won't even miss it.
- That's a good start, but there's more. Many employers will match your contribution up to a certain amount, for instance $0.50 on the dollar up to 6% of your salary. Building on the $40,000 example, that kind of match would add another $1,200 to your savings. And some employers offer a match on your student loan payments, even if you can't make a savings contribution—ask your HR department if your company offers this.
- To sweeten the deal, Uncle Sam gives you a tax break. Contributions to what's called a Traditional 401(k) are tax deductible, meaning for every $1,000 you earn, if you put $100 in your 401(k), you're only taxed on $900. Plus, both contributions and earnings can grow tax-free until they're withdrawn—which could be very significant.

- You might also have the choice of a Roth 401(k). A Roth doesn't give you a tax break upfront, but rather later when it's time to withdraw your money. But like a Traditional 401(k), contributions and earnings grow tax-free.

You can see there's a lot to like here.

Understand the rules around 401(k) plans.

Like anything, to get the benefits you have to play by the rules. One rule details *when* you can use the money. The money in a 401(k) is intended for the future. It's not an ATM machine. You enjoy the tax benefit while you're saving, but when you withdraw it, you'll pay ordinary income taxes on the amount you withdraw (unless it's a Roth). The catch here is that if you withdraw your savings *before age 59½* you'll also likely pay a 10% penalty on the amount you withdraw. So, it's best to keep it in the plan.

Another rule has to do with what's called vesting. While *your* 401(k) contributions are completely your own, your employer might require you to stay with the company for a certain amount of time to get the full company match. Seems fair; they'll give you extra money but if you leave too soon, you may not get to keep all of it.

Why a 401(k) plan can be worth it.

Those are the nuts and bolts of how it works. But to me the exciting part is how that money can potentially grow over time. Because the money doesn't just sit there. Whether it's in an interest-bearing account or invested in the stock market, your savings could grow over time. And then your earnings could also grow. That's known as compounding.

Here's an example of how compounding could work. Let's say your initial $4,000 in savings earns 5% annually. At the end of the first year, you'll have $4,200. Then add that $4,200 to the next year's $4,000. Now you have $8,200 making 5%. At the end of 20 years, you'd have almost $150,000. At the end of 40 years, you'd have over half a million dollars! And that's if you don't increase the amount you save each year. But chances are, your salary will grow. Keep saving just 10% of whatever your salary is, and the numbers keep going up.

Invest to give your money a boost.

Most 401(k) plans help put your money to work by offering a choice of investments, usually mutual funds or exchange-traded funds (ETFs). This can be a good way to start investing. Sure, there are risks, but you have an extra advantage. When you start investing in your 20s, time is on your side to help you ride out market ups and downs.

Diversification is another way to help minimize investment risk. This means not putting all your eggs in one basket. A simple way to diversify is to invest in mutual funds and ETFs, which are basically "baskets" of stocks and/or bonds. When you invest in a mix of different types of investments, you're potentially helping to lower the risk of loss by spreading your money around. Of course, that can't guarantee a profit or eliminate all risk, but again you have time on your side.

Ideas to make your financial situation even better.

I want to mention a few more things that can really help you set yourself up financially.

1. Contribute enough to your company savings plan to get the maximum match. Otherwise, you're leaving free money on the table. In 2025 if you're under age 50, you can contribute up to $23,500. Those over 50 can contribute another $7,500. Plus, there's a special enhanced catch-up contribution of $11,250 for people 60-63.
2. Pay off nondeductible, high-interest debt like credit cards. And then don't charge more than you can pay off each month.
3. Build an emergency fund to cover three to six months of essential living expenses. This is separate from your 401(k).
4. If you don't have a 401(k) or you want to save even more, contribute to a Traditional or Roth IRA.
5. When you get a raise, increase the amount you're contributing to your 401(k). Even a percent or two makes a huge difference over time.

Start now. Thank yourself later.

If I hadn't started saving a small amount in my 20s, I'd have to be saving a lot more now. Instead, when I want to buy season tickets to my favorite sports team or take an extra vacation, I can. Because I saved a little a long time ago, I have more discretionary income now.