CONTROLLING YOUR FINANCES WITH CASH FLOW MANAGEMENT

By Michael Leonetti

Every successful business relies on a cash management system to carefully control income and expenses, and that system can easily be applied to personal finances.

Your personal financial situation is comparable to that of a small business. Both have concerns for profit, income and expenses, and spending decisions affected by anticipated circumstances. Following some of the more successful business practices can help you get your own financial concerns in order.

One of the key concepts in running a successful business is cash flow management. What is cash flow management?

Every successful business relies on a financial system to carefully control income and expenses. A business must have a system to know its present financial status, and more important, to plan for its future financial moves. A corporation cannot place a $40,000 inventory order unless its controller knows next month's receipts will cover the order.

Cash flow management can easily be applied to personal finances as well, and is designed to handle your financial situation like a business in which you function as the controller.

Cash flow management is a system, not a budget. It will allow you to see your financial situation from a long-term, systematic viewpoint. You will see how one move, such as periodic tax payment, can affect your disbursements for several months prior to, and following, the actual payment. Budgets are too immediate in scope to allow you to relate a March income to a July expense.

It is essential for you to begin a systematic savings and investment program to accomplish financial and retirement goals. Every successful business relies upon a system to control income and disbursements. Your personal financial situation is comparable to that of a business, and no less important.

ESTABLISHING YOUR SYSTEM

A cash flow plan will function best if it reflects your goals, whether long-term or short-term. The purchase of a pleasure boat in three years or the decision to remodel your basement next winter should influence your cash flow plans. The goals that you have already set should help you shape your personal version of this system, so it is important to refer to them often.

What should your system contain? There are four factors that will help you establish control over money:

- *Income/Expense:* Identify and isolate income and expenses. You will need to consider whether income is gross, or net (the amount you actually have available); if it is gross, you need to set aside an expense category for taxes.
- *Category:* Define the kinds of income you receive and the kinds of expenses you incur. Categorize them according to the fixed or flexible nature of the item.
- *Time:* Your system should be based on a monthly structure, and you should quantify your income and expense within a 12-month format.
- *Amount:* Income and expenses should be expressed in dollars.

In short, your cash flow management system should examine all financial transactions over a year-long period, with income and expected expenses for

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each category broken down on a month-to-month basis. Included in those month-to-month expenditures should be a portion for savings for both short-term and long-term needs.

PERIODIC FIXED EXPENSES

Many people have lost control over cash flow because they have no system to handle periodic known expenses of a substantial nature. Good examples of this type of expense might be a large real estate tax bill of $1,500 due every March, a life insurance premium of $840 due in November or an IRA deposit of $2,000 which must be made by April 15.

What people frequently do is remember the bill a month before it is due and start scrimping. But that is too late.

The solution is to save ahead for these payments and include a portion of them in your monthly cash flow schedule. For example, for a small additional amount, an automatic bank deduction can be made regularly to cover the $840 life insurance premium. The $1,200 tax bill is due again in 10 months—why not set $120 aside each month in a special savings or credit union account? Then when it becomes due, you'll have the money. Afterward, you can reduce the monthly savings amount to $100 since you will have 12 months to accumulate the next payment.

SAVE SYSTEMATICALLY

It is also important to include in your monthly cash flow schedule a portion for your savings and investment program. Consider it an obligation just as important as any other monthly obligation. One easy way to accomplish this is to set aside a portion of your monthly paycheck.

In addition to saving a portion of monthly income, I would strongly urge that any money saved by tax planning each year be invested the following year. This will give you an additional source of investment funds as well as a means of reducing income tax liability on a regular basis.

BUDGETING

A budget is a written plan for using available financial resources to achieve financial goals. It should be used in conjunction with your personal cash flow management system to help maintain control of cash flow. Once you have set up your budget, you should periodically check your cash flow against the budgeted amounts to make sure you are on track.

How can you develop an effective budget for family expenses? Table 1 presents some guidelines—typical amounts that are allocated to general expense categories. The figures in parentheses are suggested budget limits for each category; the figures represent the percentage of your total budget *after taxes.* Needless to say, your circumstances may vary considerably from these generalizations due to income levels, family size, and personal choice. But remember that if your total percentages are more than 100%, you are living beyond your means.

CONCLUSION

Most people have not saved as much as they would have wished. The reason is not that they did not intend to save, but that they did not have a system. Lacking a system makes it very easy to be distracted by the many opportunities to spend earnings.

Setting up a cash flow management system to help you live within your budget can help put you back on track toward meeting your goals.

With a proper system in place, you will be well on the way to controlling your cash flow, rather than letting it control you.◆

TABLE 1. EXPENSE CATEGORIES AND GUIDELINES

Housing Costs (20%–35%)
Rent, Mortgage, Repairs and Improvement, Property Insurance, Property Taxes, Lawn Care, etc.

Food (15%–30%)
All Food Items, Meals Taken Out, Pet Food

Auto & Transportation (6%–20%)
Purchase or Payments; Gas and Oil; Insurance and License Fees; Repair, Parking and Tolls; Rental, Taxi and Bus Fare

Savings and Investment (5%–9%)
Long-Term Goals, Education Funding, Retirement

Utilities (4%–7%)
Gas, Electricity, Water, Waste Disposal, Telephone

Clothing (3%–10%)
All Clothing Purchases, Alterations, Repairs (Shoes, etc.), Laundry & Dry Cleaning

Medical (2%–8%)
Insurance, Drugs and Medicines, Hospital Bills, Doctor Bills, Dentist Bills

Outlays for Fixed Assets (2%–8%)
Major purchases or the payments on appliances, garden equipment, and furniture repairs (appliances and TV and computer).

Recreation & Entertainment (2%–6%)
Admissions, Games and Hobbies, Club Dues, Alcoholic Beverages, Tobacco, Cable TV and VCR Rental

Family Necessities (2%–4%)
Toiletries and Cosmetics, Barber and Hairdresser, Postage and Stationary

Mad Money (1%–4%)

Gifts*
Holidays, Birthdays, and Anniversary

Short-Term Savings*
Vacations, Other Special Purchases

Contingency*
Legal Services, Unspecified Debt

Personal Improvement*
Books, Magazines and Newspapers, Tuition and Course Fees

Disability Insurance*
Taxes*
Life Insurance*

**These categories have no suggested limits.*