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Improving Cash Flow

By Carol Tice

Gerald and Janelle Engley wanted to be as smart as possible with their money management. The Seattle professional couple always had cash left over after meeting their monthly bill obligations. But they wanted to find ways to allocate even more funds toward their goals, such as saving for their two preteen children's college educations, their own retirements, and a European vacation. So the couple consulted with Loren Pierson, a Scottsdale, Arizona–based certified financial planner with Mercer Advisors, who recommended they start categorizing and tracking their spending. The results were eye-opening, particularly when it came to clothing and food.

"It was staggering how much money we were spending eating out," says Gerald.

The Engleys made some changes—meals out and shopping trips were curtailed, and Gerald started packing his lunch instead of spending $10 daily at a cafe near work. Within a few months, the couple found that the cuts had liberated even more cash to put toward their goals. The Engleys started depositing the money into separate accounts they'd established for education and for vacations.

Families interested in savvy money management can start by examining their income and pattern of expenditures, and how they relate to the availability of cash. When families are short of cash, it's often not a question of needing a bigger paycheck, says Pierson—it's a cash-flow problem. Money is being wasted; bills are too high; debt payments are draining money away; and/or the timing of payment-due dates makes it difficult to maintain or control cash flow.

So how can families improve their cash flow? For inspiration, we sought tips from five financial experts: Loren Pierson; Robin Thompson, author of *Increasing Your Cash Flow: A Practical Financial Guide;* Sam Craig, a client advisor with Seattle's Laird Norton Tyee wealth-management firm; Seattle-based certified financial planner Ken Smith of Empirical Wealth Management; and Cyndi Finkle, a Los Angeles mom and business owner who writes about life, business, money and food in her blog, "Practical and Meaningful" (www.practicalandmeaningful.typepad.com).

IN THE FLOW

TRACK YOUR SPENDING. The Engleys used the online financial tool Mint.com to track their spending by category, but the tool you use isn't as important as simply doing it, says Thompson. Whether you use a financial website or pro software such as Quicken, or enter figures in a spreadsheet, you need to discover where your money is going before you can alter your habits.

CREATE A SPENDING PLAN. Now that you know where the money goes, you can make choices about where to cut back. Consider using the "envelope method," in which you create spending limits for each category of expense and put the cash into an envelope (you can do this virtually, too). When the cash is gone from the eating-out envelope, for example, that means no more restaurant outings until next month.

USE CREDIT RESPONSIBLY OR START PAYING CASH. It's important to establish credit and to use it responsibly. While credit-card use can offer rewards such as cash back and airline miles—and can help with short-term cash-flow issues if your income is not regular—Craig stresses the importance of paying off credit cards each month. Thompson suggests migrating toward paying for more things in cash, because you'll save money both on interest and, in some cases, on the price you pay.

THINK AFFORDABILITY, NOT MONTHLY PAYMENTS. "We've grown accustomed to thinking, 'As long as I can afford the monthly payment, it's OK,'" Thompson says. “Look at the total cost of the transaction instead of the low monthly payment.” Waiting until you have the cash to make a purchase cuts your expenses by eliminating interest. Another option, according to Craig, is to ask vendors whether they offer interest-free credit.

Save for emergency expenses. You may not be able to predict when your water heater or roof will need replacing, but you know that sooner or later, it will. Create a “rainy-day” fund for these types of unpredictable costs.

Anticipate predictable expenses. In addition to the rainy-day fund for unforeseen expenses, Craig recommends having a “cash-flow buffer” that enables you to cope with predictable, sizable expenses that crop up quarterly or annually—such as tax payments, subscription fees, automobile licensing or a summer vacation—so that

Dave Ramsey’s Plan

Personal-finance expert Dave Ramsey helps consumers reduce debt and save money on his national radio broadcast, *The Dave Ramsey Show*. Here is the “Seven Baby Steps” plan for financial freedom, from Ramsey’s *The Total Money Makeover* book.

- **Build a $1,000 emergency fund.** This protects you from the little emergencies that cause you to go into debt.
- **Attack personal debt.** Pay off all personal debt except for your house.
- **Save more.** Build a savings account with three to six months’ worth of expenses, to protect you from larger emergencies.
- **Put 15 percent away for retirement.** Begin with 401(k) plans (where your company might add more in matching funds) and Roth IRAs.
- **Start a college fund.** But don’t do this until you’ve completed the first four steps.
- **Pay off the mortgage.** Pay extra on your mortgage until your house is paid off.
- **Build wealth.** Don’t forget to give generously to charity, too.

you have money on hand when those bills come due. Many people view a tax refund as an opportunity for a spending spree, Thompson says, but that windfall is a great opportunity to build up savings. Craig suggests starting off the year by anticipating these lump-sum expenses, and allocating any extra money—such as a bonus or tax refund—toward your cash buffer.

Make pretax retirement contributions. To cut your tax bill and free up more spending cash now, put your retirement savings into an account such as a 401(k) or traditional IRA, where each dollar put away reduces your taxable gross income, says Empirical Wealth Management's Smith.

Eliminate tax refunds. If you're getting a big refund each year, consider adjusting your paycheck deductions and keeping more money in your monthly budget. Otherwise, "it's an interest-free loan you're giving Uncle Sam," Thompson says.

Refinance debt. If you've got a car loan, a student loan and credit card debt, you'd probably lower your monthly payments by getting one consolidated loan, notes Smith. If you have to, spread payments over a longer term to lower your monthly obligation, but keep in mind there's a trade-off of having to pay more interest that way.

Re-examine fixed costs. If you haven't compared insurance prices or phone plans in a while, you may be spending too much, says Smith. If you have home and auto insurance with different carriers or have more than one provider for phones, Internet and cable TV, you may save by switching all your business to a single company. You may also save on fees by paying a year's insurance premiums up front or paying for three months' worth of prescriptions at once. Take a hard look at your insurance coverage, too—raising your deductibles could yield substantial savings.

Eliminate late fees and overdrafts. Mercer's Pierson recommends setting up bills to auto-pay electronically in order to avoid penalties. Late fees can cause a domino effect that leads to financial trouble. "You've overdrawn on a $4 latte, and now it costs more than $35," he says. "Then they ding your credit score." Another benefit of automatic payments is that they can be set to fund the day they're due, keeping cash in your account as long as possible.

Smooth out payment due dates and expense lumps. If you're running short of cash because too many bills fall due at the same time, talk to creditors and see if due dates could be changed. Or, if you're paid monthly, talk to your employer about getting on a biweekly pay plan to help avoid a month-end cash drought, says Pierson.

On the flip side, consider switching your mortgage bill to half-payments every two weeks. Under this program, you effortlessly make two extra payments each year, shaving thousands in interest off your mortgage.

Think hard about big purchases. The Engleys were contemplating buying a new, larger home rather than upgrading their current one. But an analysis by Pierson revealed that getting a new mortgage would result in the couple's needing to work at least two years longer before retiring. "When we looked at that breakdown," Gerald says, "we didn't want to move."

Declare a no-spending month. At least once a year, blogger Cyndi Finkle and her husband, Temple Williams, take a whole month off from spending. They do buy fresh fruits and veggies, and pay bills, but other spending is avoided. Restaurants are banned in favor of eating what's on the shelves and using gift cards for treats, and they read books for entertainment.

Finkle says the "no-spend month" has a spillover effect and keeps their spending down in the following months, too. With what they've saved, the couple is able to pay cash for extras such as unexpected repairs or vacations. "We're never having to play 'catch-up' financially," she says.

The key to money management, says Craig, is having a plan for month-to-month cash flow, as well as for the long term. "And, it's important to adjust that plan as your life changes, whether it be a temporary situation or a larger life transition." ▲

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