



# Cashflow Matters

How managing your cash  
could change your life

Macquarie Cash Solutions  
Smart cash management solutions made simple





# Managing your money.

## New Zealand's cashflow quandary

Over the past decade New Zealand's economy has been expanding vigorously, with the annual average rate of growth recording 3.75%. Furthermore, increases in real Gross Domestic Product (GDP) per person have outpaced the Organisation for Economic Co-operation and Development (OECD) 10 year moving average, placing New Zealand in the top half of the OECD, a position not held since the 1980s.

On the economic front there is good news in most places you look. Interest rates are stable, wages have been rising, the New Zealand dollar has rallied, and our stock exchange has been a strong performer amongst the world's major markets. In addition to this strong economic performance, unemployment has fallen to near 20 year lows, currently below 4%.

### So where has the money gone?

However, there is a shadow over this rosy scene. Many New

Zealanders haven't used these "years of plenty" to turn good fortune into real, accessible wealth. For a country where incomes have been rising and employment has been strong, we are deeply in debt.

According to the Reserve Bank of New Zealand (RBNZ), household debt as a percentage of income has skyrocketed from 50% in the 1980s to 140% in 2004. New Zealand's net savings ratio is now **negative** 12.3% of income (in 2004), down from a peak in 1980 of 5.8%.

How could this be so? How could a country enjoying unprecedented prosperity get itself so deeply into debt?

Because it's not making money that's our problem. New Zealanders are some of the hardest working people in the world – but we're not so good at managing the money we make.

**In short, we have a cashflow problem.**

The seven deadly sins. Food, clothing, firing, rent, taxes, respectability and children. Nothing can lift those seven millstones from man's neck but money; and the spirit cannot soar until the millstones are lifted.

– George Bernard Shaw (1856 – 1950)

# Cash poor.

## Why cashflow matters

Later in this booklet we are going to look at the importance of managing your cashflow, the traps people fall into and how you can take control of your cash – for ever. First let's look at why it matters.

### Rainy day money

The RBNZ calculates that the average level of household debt is equal to 1.4 years of income. This implies that many New Zealanders will be burdened with high levels of debt for years to come.

Our high debt and low levels of saving means few of us are prepared for shocks to the economy. If New Zealand slid into recession, if unemployment or interest rates rose, many of us would have insufficient savings to help us through the bad times.

This worrying lack of rainy day money is partly explained by the long boom we've enjoyed. Many young New Zealanders have enjoyed rising prosperity for the length of their careers. They can't *remember* a rainy day.

### Retiring poor?

Low savings and high debt also has implications for retirement planning, especially with an ageing population and a shrinking workforce to support them. Future taxpayers may have to pay for the retirement of a baby boomer generation that has been spending rather than saving.

The ageing population creates pressure on the long term sustainability of New Zealand Superannuation, with the fund designed to cover only part of the increase in New Zealand Superannuation payments and higher future health costs. The recently introduced voluntary contribution scheme, known as 'Kiwi-saver', only goes part of the way to fixing the problem.

A recent Treasury report indicated the developing trend for home ownership by older people is heading lower, especially with respect to low income earners. The key drivers are deemed to include a shift in consumption patterns away from housing, later marriage and reduced affordability.

Treasury also expressed concern about the effect of increased household liabilities on retirees.

The increasing debt level sounds warning bells on whether the ageing population is making adequate provisions for retirement – instead it appears to be consuming today.

### Bricks and mortar

Much of the money New Zealanders earned over the past decade went into residential property. Many home owners would argue that a home is an asset (for more on this argument see p 8) and that retirees can sell their house, live in a smaller property and use the capital gain to supplement their retirement savings.

In reality, downsizing on retirement can be hard to do. Emotional attachment and the convenience of living near friends and relatives make it difficult to move to a cheaper, less central location. Downsizing may not free up as much capital as expected as you incur legal and transaction costs on both selling and buying.

### What goes up...

The other problem with relying on the family home to fund your retirement is that the price may be less than you expect. Our long housing boom may make this

hard to believe, but according to the Governor of the RBNZ Dr Allan Bollard (January 2004), “there are elements of speculative bubble behaviour present in recent house price developments”. Such a scenario indicates that capital values could decline in the future, should the bubble burst.

House prices can decline for long periods. Japan enjoyed a massive housing boom in the late ‘80s. But as *The Economist* (9 December 2004) points out, Japanese property prices then dropped for **13** consecutive years from 1991.

### Bad habits

Despite years of improving employment prospects and a strong economy, many New Zealanders have insufficient savings, excess debt and rely too heavily on their residential property to fund their retirement. Unfortunately, their financial position doesn’t reflect just how hard they’ve worked. Why? Because they’ve got poor cashflow habits.

It is a kind of spiritual snobbery that makes people think they can be happy without money.

– Albert Camus (1913 – 1960)

# Bad Habits.

## Your cashflow plan

Changing ingrained money habits is particularly hard because money habits are rarely taught. Most of us inherit them from our parents.

Psychologists tell us that one of the keys to changing an ingrained habit is to have a replacement habit waiting to take over. The following steps may help you get started.

### 1. Get emotional

Money – and the lack of it – can be an emotional subject. You should use that to your advantage. To create an *emotional* commitment to building a better cashflow management system you need to visualise the benefits it will bring you.

The best way to do that is to write down your money goals. Your goals might include:

- a larger retirement nest egg
- an earlier retirement
- more money for travel
- leaving money for your children

Make sure you don't limit those goals to what you think is achievable given the way you manage money *now*. You're about to change all that, so it may be appropriate to write down what athletes call 'stretch' goals – exciting targets that demand continued improvements in performance but are not impossible.

When setting your goals there are all sorts of issues to consider.

- your age
- health
- upcoming financial commitments
- short-term obligations
- existing debts and assets
- likely income

Once you have those goals written down you will have a stronger motivation to change your money habits. Make sure you put a timeline next to those goals – they need to be both achievable and *measurable*. It's also important to update them regularly to account for changing conditions and changing priorities (like starting a family).

The easiest way for your children to learn about money is for you not to have any.

– Katharine Whitehorn

## 2. Pay yourself first.

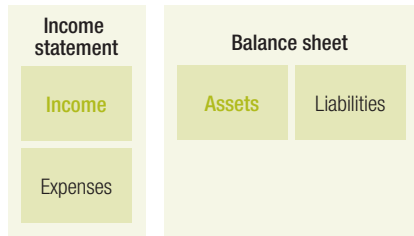
As long ago as 1926, author George S Clason summed up the keys to cashflow management using fables set in ancient Babylon. He wrote: “A part of all you earn is yours to keep”. Those words ring true even now – when credit is easy and choices plentiful.

One of the most difficult but more important parts of cashflow management is having the discipline to pay yourself a set amount to cover your day-to-day living expenses. By using a central cash hub you can arrange to have your living expenses and bills automatically transferred into a transactional account for you to access, whilst accumulating the remainder of your salary in the cash hub - so the money you work hard for starts working hard for you.

## 3. Think like you're in business

You don't have to run your own business to be successful. You do have to think like a business person.

## Financial education

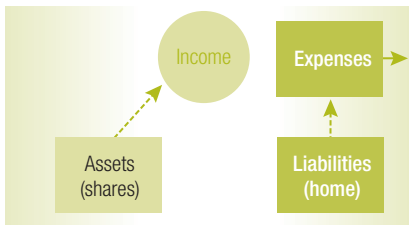


All businesses use two common measures to monitor their cashflow – an income statement and a balance sheet.

The income statement measures income over expenses – it tracks what you're earning against what you're spending. The balance sheet compares your assets against your liabilities – what you own versus what you owe. Businesses use these measures to assess all financial decisions – investment, borrowing, cost-cutting, expenditure. You should do the same.

Like any business you should understand your own income statement and balance sheet and review them every year and track your progress.

## Cashflow patterns of assets and liabilities



The cashflow pattern shown here illustrates how the income statement and balance sheet link to cover the four key cashflow factors – income, expenses, asset and liabilities. It reinforces yet again the importance of building assets and reducing liabilities. Assets create income. Liabilities create expenses.

### Cost to income

Your income statement will also lead you to understand another key cashflow measure – your cost to income ratio. Your cost to income ratio is, simply put, the percentage of your income (i.e. salary or wages) that goes to meeting expenses (accommodation, food, entertainment, insurances etc). Good companies want to minimise their cost to income ratio – it's a crucial measure, for example, in the banking sector. If you know your own cost to income ratio – what percentage of your income goes to meeting expenses – you'll be better placed to save money, reduce debt and start to build positive cashflow.

By thinking like a business – and tracking your own cashflow measures – you'll better understand your existing financial position and how you manage your money. Working with the help of a financial adviser or accountant you can then take concrete steps to improve your financial position.

## 4. Start a budget

The first step towards controlling your cost to income ratio is a budget. Before you start a budget however, it's imperative you have an understanding of your entire financial position. Writing all of your expenses down helps. There is a handy budgeting workbook accompanying this booklet, that can help you get started. *'Your cashflow plan - Are you spending too much money?'* is available from your Adviser.

## 5. Get Advice

One of the most under-rated jobs of a financial planner is to help you learn better cashflow management. Their expertise means they can give you personalised advice on ways to manage your cash more effectively.

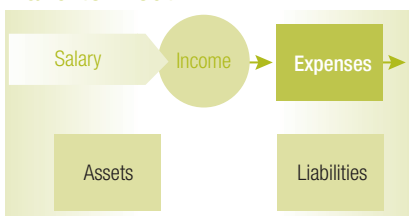
# Safe hands.

## How to handle your cash

Rich or poor, young or old. It doesn't matter whether you are a sophisticated investor or starting your first job. It doesn't matter whether your cash comes from salary or wages, business income, share dividends, rent or even social welfare payments. What matters is how much of your cash you keep – and how you handle it.

While individuals manage their cashflow in many different ways they often fall into one of three cashflow patterns. Understanding how to handle your 'cashflow' is a first step on the road to financial success.

### Cashflow Pattern No.1: Hand-to-Mouth



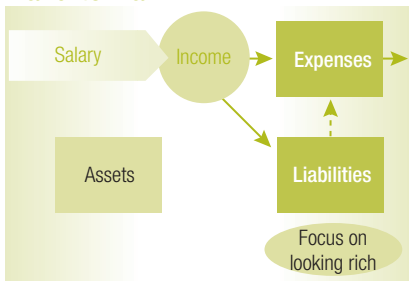
As you can see, a hand-to-mouth cashflow pattern is simple. Money flows in as wages or salary and flows out to pay expenses. None of the income is saved or used to buy investment assets.

People caught in this cashflow pattern rarely have long-term debt such as a mortgage because they cannot afford it or are a poor credit risk. However, they often use short-term debt – such as credit cards – to manage the different timing of their income receipts and expense payments.

The lack of savings is the obvious problem. There is no capital being stored away for a rainy day, no wealth being accumulated and no money set aside to prepare for retirement.

Perhaps surprisingly, many highly paid people have a hand to mouth cashflow pattern. They earn high incomes, but all the income is spent. With easy access to short-term credit, they can live an expensive and expansive lifestyle, but only if nothing goes wrong, if they keep their job and stay healthy. Unfortunately, they almost guarantee themselves no change in wealth at the end of each year, and as a result a depressing lifestyle change in retirement.

## Cashflow Pattern No. 2: Hand-to-Bank



The risks for those stuck in hand-to-mouth cashflow pattern are obvious. But there are other ways to handle your cash that on the surface appear far more prudent – but in reality are just as risky. People who exhibit this cashflow pattern tend to divide their cash. They pay their expenses and buy items such as cars and high-end consumer goods. It's tempting to believe these items are assets, after all, they are tangible, expensive, useful and fun. But they cost money rather than generating money. This cashflow pattern allows you to look *and* feel rich. But it won't make you rich because none of your cashflow is doing the job of generating more cash. Instead, your liabilities add to

your expenses – you pay interest on your mortgage, pay to buy/lease and run your car and pay to meet the credit card bill on the new plasma TV.

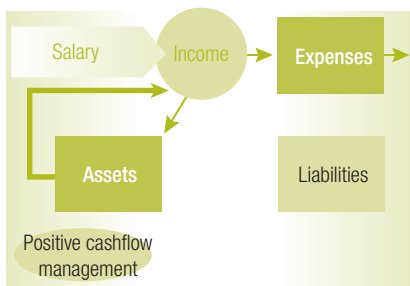
In other words, you take your hard earned cash, and one way or another, hand it to the bank.

At the heart of this hand-to-bank cashflow problem is the confusion between assets and liabilities. Assets pay you money. A liability takes money from you. Or put another way – assets feed you. Liabilities eat you. That's why your home is not always an asset. It generates no cash to support a financial strategy. Sometimes your home is a liability – because you pay rates, utilities and maintenance costs. It only becomes an asset if, and *when*, you sell that property for an after expenses profit. And that's one of the reasons you should consult a financial adviser when you're thinking of buying a property. They'll help you make sure your decision makes financial sense

Thousands upon thousands are yearly brought into a state of real poverty by their great anxiety not to be thought poor.

– William Corbett

### Cashflow Pattern No. 3: Handled for Growth



As you can see, the third cashflow pattern is markedly different from the other two. The key line on this cashflow chart is the flow of money from assets back into your income – that is the income generated from investments that create more cash.

By investing in assets – bonds, shares, property, managed funds, alternative assets, infrastructure and businesses, you are *creating* cash. Cash that can be used to meet expenses, and most importantly, invest in further cash-creating assets.

It is at this point that the distinctions between the cashflow patterns become most obvious. While many people live hand-to-mouth, or hand all their cash to their bank, the smart people handle their cash so it creates more cash. The rich may own expensive properties – they may even live in one of them. But the bulk of their property holdings are investment assets that generate rental income exceeding their cost. That's why many successful property investors don't live in the properties they own. Instead they negatively gear – borrow to buy **income-producing** property and as a result enjoy a tax advantage on their interest payments and property expenses. And they don't buy property for emotional reasons, but because they have a realistic probability of selling for a capital gain.

To achieve genuine financial success – and all the lifestyle and emotional benefits that go with it – you need to make sure you handle your cash so that it grows. You need to create positive cash flows and invest in assets not liabilities. The result is that you will have created an additional source of income – over and above the income you earn. That's what real wealth is.

# The debt traps.

## How to spot the cashflow killers

According to the RBNZ (June 2005) New Zealanders now owe around \$112 billion – almost doubling in the past 5 years. Much of that debt is tied up in mortgages but we are also voracious users of credit cards.

The RBNZ calculates consumer debt makes up nearly \$11 billion of total household debt, of which a large proportion is credit card debt. The RBNZ recently reported that “from mid-2003, the increase in mortgage debt exceeded the amount required to fund the value of new residential investment”. This shows that our consumption binge extends further than the consumer debt figures suggest.

New Zealand’s long boom, strong employment and the easy availability of credit has changed our cashflow patterns – a fact that’s reflected in our low national savings rate. Over the past decade, borrowing has outstripped growth in incomes, and the ratio of debt-to-disposable income and the ratio of debt-servicing costs-to-disposable income had both risen to record highs.

### Financial Education

A government sponsored taskforce is now working on proposals to

teach financial literacy in schools. Unfortunately that’s too late for many of us and in the absence of better financial education, going into debt to buy our own home has become our default investment strategy. And it’s a strategy that can reinforce bad cashflow habits.

### The debt rollercoaster

The rollercoaster starts when you borrow to buy your own home. Because your debt is backed by a property you become what banks call ‘a good risk’.

Within months of taking out a mortgage you are likely to be offered a new credit card with an expanded limit. This extra credit comes in very handy, offering you the chance to complete any renovations and buy the new furniture, appliances and entertainment technology you need for your new home.

And of course, the most exciting part of the rollercoaster is your home loan redraw facility. You can now redraw (or re-borrow) some of the money you’ve paid back on your mortgage. That’s a large extra slice of credit you can use and, because it’s a part of your mortgage, it’s at a lower interest rate than credit card debt.

## The steep descent

One of the reasons it's easy to ride this debt rollercoaster is because it's so popular. Indeed many customers would regard the ride as part of a responsible financial plan. Yet unless you're focused and disciplined it can become a deeply flawed strategy.

- The amount you can borrow is now tied to the value of your home rather than the size of your income. You now have access to more credit without any increase in your ability to pay it. Unless you are disciplined you will find yourself making minimum repayments that satisfy your bank rather than reduce your debt. And while your debt is backed by a property, using that property to pay your debt is the last of last resorts.

- By using a redraw mortgage (rather than a separate account) your cashflow is now run through a bottomless pit – the expenses side of your income statement and the liabilities side of your balance sheet. The very nature of this structure makes it harder to stay focused on your cashflow. You can end up *paying yourself last*. You have lost control of your cashflow – and given that control to your bank.
- With almost unlimited spending power and little control of your cashflow, it's difficult to monitor and manage the flow of money or to reduce your cost to income ratio. The only solution is to work harder to increase your income. Yet, if the structure of your cashflow management is faulty, adding more income won't fix the problem – it may just fuel higher spending.

Annual income twenty pounds, annual expenditure nineteen six – result happiness.

Annual income twenty pounds, annual expenditure twenty pound ought and six – result misery.

– Charles Dickens (1812 - 1870), *David Copperfield*

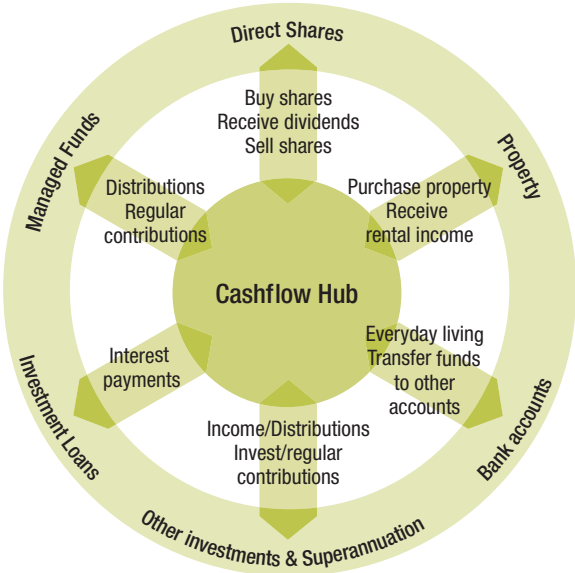
# Visibly different.

## What you need from a cashflow management system

We've looked at the commitment it takes to build a positive cashflow pattern. We've discussed some of the traps to avoid. Now it's time to turn your cashflow strategy into a system – “a way of doing things.” So what are the characteristics of a good cashflow management system?

### A hub

You need a central, independent cashflow hub. A single account that receives all your income and makes all your payments. Having all your cashflow managed from a single account means you can monitor and manage your cash – and that's the key to managing savings, investments, liabilities and expenses.



## Spokes

Your cash account must be able to accept money from all sorts of sources – for example: your employer, your investments, New Zealand Superannuation or tenants. It also needs to be able to pay out cash – to make other investments, pay expenses and professional fees, pay the IRD and help you meet your day to day needs.

## Competitive interest rates and low fees

You don't want managing your cash to cost you money. Yet most people manage their cash from transactional accounts characterised by low interest rates and numerous fees. You need to find a better solution.

## Visibility

Visibility is perhaps the most important part of your cashflow management. It is crucial that you – and your advisers – can see how, when and where your cash flows.

The art of living easy as to money is to pitch your scale of living one degree below your means.

– Sir Henry Taylor

# A cash management engine.

## Macquarie Cash Solutions

Macquarie Cash Solutions offers you two leading edge cash accounts designed to help you take advantage of local and Australian investment opportunities: the New Zealand dollar Macquarie Gilt Edge Access Account (GEAA) and the Australian dollar Macquarie Cash Management Trust (CMT).

Macquarie Cash Solutions accounts enjoy strong credit ratings from Standard & Poor's and allow you to seamlessly move funds from one account to the other to ensure you always have funds available in the right currency when you need them.

More importantly, they are *designed* to act as a cash hub and to help you manage your cash flows.

Here's how...

### Complete cashflow monitoring

All your transactions appear on consolidated statements that provide a detailed narrative on each transaction. Accounting, tax returns and long-term record keeping are all much easier and you enhance your ability to calculate cashflow measures such as cost-to-income

ratios and your personal income statement.

In addition to regular reporting, your Macquarie Cash Solutions account gives you online flexibility and control. It offers you real-time access to account balances, transaction histories and records of interest payments. It also allows you to view any pending transactions and download statements.

### Easy links

A range of internet and electronic connections makes it easy to link your Macquarie Cash Solutions account to all your sources of income. You can have your salary, wages, investment income, share dividends and the proceeds of other investment sales immediately cleared and available in your account.

Using the Macquarie online services you can direct payments to any individual or organisation that can provide you with a bank, branch and account number and name. You can also set up direct debits and automatic payments from your account.

Money is like a sixth sense without which you cannot make a complete use of the other five.

– Somerset Maugham (1874 – 1965), *'Of Human Bondage'*, 1915



### **Share information and access with other professionals**

One of the many advantages of having a single cashflow hub is that it makes it easier to share information with advisers such as a financial planner or stockbroker.

By giving your advisers access to your Macquarie Cash Solutions account information you ensure they too have a complete picture of your cash flows. Online statements, transaction histories and annual income summaries make it easier – and cheaper – for your accountants and advisers to help you monitor your investments.

That means they can give advice based on your overall financial position and use the latest information when it comes to making investment decisions with you.

### **Low costs, competitive fees**

Macquarie Cash Solutions accounts charge no transaction\*, entry or exit fees. And a competitive interest rate helps ensure your cash holdings outstrip inflation. (\*Government, management and cheque book fees apply.)

# Cash kings.

## Useful sources

- Financial planners and accountants can help you structure your finances in ways that help you manage and monitor your cashflow and tie a positive cashflow system into your overall investment portfolio.
- Some important books expanding on the principles outlined in this booklet:
  - *Rich Dad, Poor Dad: What the Rich Teach Their Kids About Money – That the Poor and Middle Class Do Not!* by Robert T Kiyosaki and Sharon L Lechter
  - *The Richest Man in Babylon* by George S Clason
  - *The Road to Wealth* by Paul Clitheroe
  - *Making Money Made Simple* by Noel Whittaker
  - *What Rich People Know and Desperately Want to Keep a Secret* by Brian Sher
- For tips on saving and budgeting and information on investing visit the Retirement Commission website at [www.sorted.org.nz](http://www.sorted.org.nz)
- If you want more information on Macquarie Cash Solutions and how they can help you take control of your cash flows visit [www.macquarie.co.nz](http://www.macquarie.co.nz), call 0800 650 125 or speak to your financial adviser.

If you have any questions or require more information, we recommend you speak with your financial adviser or contact Macquarie:



0800 650 125



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