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Cash Flow is King!

My first full year with Burke Financial Strategies will also mark my twentieth year in the financial services industry. Having had a minor course of study in Social Work, I was much more interested in solving financial problems than in selling product. Twenty years ago, however, there were few financial professionals that would (or perhaps could) assess the broader picture for their clients.

About seventeen years into my career, I was Director of Financial Planning for a national insurance company. I had just finished presenting at a financial planning seminar of successful insurance agents. On my way to dinner, two of the attendees pulled me aside. They wanted to shift the focus of their practice from insurance sales to financial planning, in the hope of providing the best possible experience for their clients. They admitted that after discussing their clients' objectives, they felt unsure of where to start the financial discussion. I told them, "Cash flow is king. Have every client calculate the household cash flow." Everything else will flow from there. I have focused on this with hundreds of clients and advisors.

Net cash flow is the difference between inflows and outflows, or more simply, income minus expenses. It seems intuitive enough, yet so few know their net cash flow with any certainty.

Knowing your net cash flow is important for a number of reasons. First, it provides a simple assessment of financial health. If net cash flow is consistently negative (i.e. more is spent than earned), it could signal a problem. If net cash flow is positive (i.e. more is earned than spent), it generally indicates a more healthy financial position. Second, knowing your net cash flow gives context for the discussion that is at the top of most families' financial goals… retirement. Third, positive cash flow is required to implement financial recommendations. Finally, but certainly not least important, it is something over which you have some degree of control.

Calculating this may seem like an awful amount of work. Here is how you start. Collect the front page of your bank statements for the last year. Add up the credits from each statement. Add up the debits. Subtract the debits from the credits. The answer is your net cash flow. You will likely be surprised by the result, good or bad. Admittedly, calculation of net cash flow can be significantly more complex, but you will learn a lot about your financial health through this exercise. You may follow up by identifying savings and investments, as they show as outflows, but act to improve your financial position.

I have found that many clients become interested in looking more closely at source of their debits. One client decided to break down expenses into "wants" and "needs." Then the "wants" were broken down into "his," "hers," and "ours." They negotiated how to allot the "wants." They began to budget and found ways to save. I was so thrilled their process yielded such positive results.

We, as financial advisors, use the net cash flow figure in a lot of ways, too numerous to list here. Suffice it to say that it is an important component of helping you to achieve your goals.

The retirement planning implications of understanding the components of your cash flow cannot be overstated. We have provided retirement analyses for many of you. There are a lot of variables that figure into a retirement analysis. Without reliable cash flow figures, the rest of the calculations would be of little use. This applies to retirees as well.

Through twenty years of providing financial advice, I have witnessed incredible change in how personal financial issues are addressed. Financial planning, itself, has evolved. But despite all of those changes, cash flow will always be king.

Sincerely,

Christopher M. Trainor, CFP®
Financial Advisor