KRD FINANCIAL ADVISERS LIMITED

Tailored Financial Planning & Advice

A Guide To

Cash Flow Financial Planning

Contents

Introduction

Cash Flow Financial Planning, sometimes known as cash flow forecasting or cash flow modelling, is a process of using software to analyse your long-term financial position.

There are many products that can be used to do this, which vary in their methodology. Generally, all cash flow software programmes use the same ***fundamental approach***.

The basis of the approach is this:

The software works by producing an analysis of the in and out movement of money throughout a person's lifetime. It can be adapted to work for a couple, as well as just for an individual.

As a result if you use such software for your position - it will enable you to summarise your finances today, inputting details of your current income and expenditure, assets and liabilities. You then add in future expected events, for example a retirement pay out, alongside a series of assumptions about future rates of inflation, investment returns, borrowing costs and so on.

This will then produce a long-term picture – and the detail - of **your lifetime cash flow**.

What Cash Flow Planning Is NOT!

Some commentators and advisers will criticise cash flow financial planning as being an impossible task, possibly one that can ill-inform the individual or couple going through the exercise.

The criticism is based around the difficulty and unreliability of trying to make long-term predictions, often decades into the future. However this is based on a misunderstanding, possibly down to semantics.

It is true that many people call the exercise **cash flow forecasting** and this is where the problem lies. If it was, indeed, simply a forecasting exercise then the critics would have a point. Because no-one can predict the future, even the next few years, let alone decades ahead. In reality, **modelling** is what this is all about.

There is a big difference between modelling and forecasting. Modelling is an exercise which runs a series of scenarios to look at what happens if you change different numbers, assumptions and event timelines around your future pathway.

Forecasting is an attempt to predict what will happen.

The difference between 'what if' and 'what will' is the important factor.

What Can We Discover?

The whole purpose of the cash flow exercise is to provide invaluable information and insight into your ***financial planning***.

The objective is to be able to look at future possibilities, analyse these and make better decisions now.

By running a long-term financial projection, which includes testing different scenarios, certain highly important aspects can be identified.

A simple example is to see what happens if you change key dates.

Imagine running the scenario to test the difference in your picture if you retire at 55 or 65. This may help identify what sort of shortfall occurs, which in turn may help identify ***what you need to do now*** to bridge this shortfall.

Goals

Cash flow planning is essentially about linking the here and now with your **life goals**, using the process to provide clear direction towards your financial plan.

Please note the emphasis on the word 'life' above. Life goals are different to financial goals.

Your life goals are about your aspirations, the lifestyle you want to enjoy, your wider wishes and generally anything you can stipulate that you want to achieve within your lifetime. They are always personal (after all, they are your life goals!) and will often be subject to considerable review.

The key to successful financial planning is that link between the goals and the decisions and actions you take in respect of your finances, to plan to meet those goals.

Although your life goals are not financial goals, in the process of doing the cash flow planning **they are effectively converted into financial targets**.

For example if one of your goals is to be able to retire early, by its very nature this can only be tested for viability by measuring the impact of the financial outcome of different retirement dates.

Scenarios

As mentioned earlier the real value of this approach is the testing of different scenarios. This is often where the mist starts to lift. If you can view different future outcomes which occur when you change different assumptions, you can start to see the impact pursuing different actions makes.

We cannot emphasise enough how illuminating this is and how much it can affect the decisions in the shorter-term.

It is worth repeating the value to you is not that you will have a reliable forecast of what will happen in the future, but you will have a very good idea of how different pathways affect what the future could look like.

What If?

This scenario aspect is like playing a comprehensive game of asking 'what if?' in relation to dozens of different aspects of your future financial position. What if you change the date you retire, what if you inherit a sum when you are 60 as opposed to 80, what if you pay off your mortgage or leave it untouched, what if you need care, what if you live to 105?

Also what if your investments grow at 2% per year as opposed to 5% per year, what if you double the amount you save, what if you have to cope with inflation at 4% per year instead of 1.5% per year?

What if you start taking your pension income at 60 or leave it to 65? What if you change the income you take from your savings from £15,000 per year to £25,000 per year?

The problem with doing this exercise if you are **not** using sophisticated software, designed for this very purpose, is that you will struggle to cope with the variables. Attempting this on the back of an envelope would be very difficult!

To properly expose the differences future variation in assumptions would make needs modern technology and software which can crunch the numbers.

The cash flow modelling software does this.

How Much Is Enough?

One of the most common references around cash flow planning is the question of your 'number'.

The principle here is to understand what amount of money represents enough. The number being the amount of money to ensure you have enough for the rest of your life, come what may, however long you live.

Once again this is highly personal, dependent on circumstances and your lifetime goals. It is also likely, in many cases, to need to include and respect your legacy wishes.

For example, if it were possible (and it is not) to work out your exact number to the penny so that you run out of money the day you die, for the majority of people this would be unsatisfactory. This is down to the fact that legacy planning and leaving wealth to the next generation are incredibly important factors.

Financial Freedom Date vs Retirement

The world has changed considerably in the last 20-30 years. One of the biggest impacts of the changing economic and social landscapes is the nature of retirement.

In the past retirement tended to represent a fixed point in time. People would work during their lifetimes, receiving a salary and then would retire on a given day and live off a pension. The norm today is quite different and the trends suggest these will accentuate. Here are some of the key factors:

- More people than ever now run or operate within their own businesses (nearly 5.5 million in the UK are now in this position);
- Most of these are small businesses;
- Very few employees now stay in one job, many employees move around quite liberally throughout their working lives;
- Outside of the Public Service, old-style final salary pension schemes, with generous guarantees, have all but disappeared;
- People are living a lot longer in retirement;
- The demand for products and services for individuals age 60 + has grown;
- The proportion of the population age 60+ has increased radically;
- More people than ever are on second or third marriages;
- More people want to continue working in 'retirement years' or want to stagger their retirement, working part-time or slowing down;

This leads to a very different planning position. For many people today the primary aim is not to have enough money to retire on a certain day, **but to achieve financial freedom at the earliest possible point**.

This is because of the need, given those factors listed above and others, to have maximum flexibility aligned to lifetime security.

Such flexibility and security is provided by achieving financial freedom.

This means that one of the goals we can explore with individuals is the goal of achieving financial freedom and when this day could be. The cash flow modelling will enable us to do this.

The old way was to explore the question of "how much do I need to retire?" Today, retirement is almost a peripheral aspect in terms of the planning, the more important aspect is to establish a pathway which ensures you always have enough (financial freedom) regardless of when you retire.

Shortfalls

When a cash flow model is established it can show shortfalls, for example at a certain age and for a certain period. These shortfalls are crucial, as these are the points, according to that model, when you will run out of money or have to reign back. Or it may be that you will not be able to meet your predicted/expected expenditure.

These shortfalls, in whatever form they show up, explain why the exercise is so powerful.

If you think of the exercise as applying a long lens, it allows you (and your planner/adviser) to view, well in advance, where, how and when ‘problems’ are surfacing.

This in turn allows for one of the “what if?” questions to be applied, for example “what if you save 10% more of my income for the next 15 years?” If you then assume this into a revised model and it shows the shortfall disappearing, you can then consider if this is the appropriate decision (and action) to take now.

You could then start looking hard at your current income/expenditure position and habits to work out how to save 10% more.

Or you might determine that you need to invest differently, instigate a partial retirement rather than a full retirement, or sell your home and downsize at a particular future point.

Naturally, there are endless possible ways which you could alter the future picture if you change the assumptions you have placed into the software.

The shortfalls emphasise the longer-term threats and allow you to make short-term decisions to start eradicating or dealing with those threats.

How It Works?

It is very important to understand that this is not meant to be a rigid exercise or approach, which has no room for flexibility. The cash flow planning approach is always there **to inform** the financial planning decisions, not make them for you or automate them.

The object of running the cash flow is to produce a picture of the future pathway and to connect your goals with your short-term decisions.

Cash flow Planning involves two processes, knowing what cash is coming in, what cash is going out and being able to plan for it.

The future forecasts analyse your income and expenditure over the long-term and given the assumptions, it will outline whether a lifestyle can be maintained and your financial goals met.

If there are shortfalls and/or you run out of money (based on the assumptions) it will show you how, by how much and when.

You can increase the inflows or outflows of cash by changing the assumptions.

One important aspect, very relevant in today's market, is the assumptions will include an investment return on pensions, savings and invested sums. Moving the future assumed return up or down is likely to change the picture considerably.

This can inform you and your planner/adviser about the level of return you should be targeting.

In many cases this could show that you need **lower returns** that your portfolio is set-up to produce, which would suggest you can take less risk. **This de-risking conclusion is not uncommon as an outcome and can help families see that they can focus on preservation as opposed to accumulation.**

Where Cash Flow Planning Can Make A Big Difference

Here are some examples:

- You own a Business or a share in a Business and want to know when you should aim to sell out and what sort of sum you should target.

- You are getting close to retirement and want to know how much return you should be getting on your invested sums to hit your financial freedom amounts.

- You are heavily invested into pension funds and are not sure if your current investment mix is involving too much risk.

- You are looking towards your later years and want to ensure you are fully covered should you need to pay for care fees.

- You are weighing up future retirement options and want to see the difference between partial, staggered retirement, as opposed to an outright retirement.

- You want to consider your legacy position on death and fathom what your finances need to look like throughout your pre and post retirement period to ensure you leave a decent sum to your beneficiaries.

- You are in retirement taking an income and wish to see what situations lead to a position where you run out of money.

These are examples, but there are many ways cash flow planning can be used, virtually any question relating to your long-term goals and their viability – or more importantly exactly how best you can go about meeting them – will be supported by running the software.

Financial Planning

The process of cash flow management involves understanding the components that make up where money comes from, where it goes and what decisions are needed to meet lifestyle goals. It is a process which supports the financial planning and is one which should be continually reviewed and repeated.

Financial Planning is a method of arranging one's finances around a strategic approach. In the old days people tended to organise their affairs through the use of financial products which were commonly purchased through banks and insurance company sale forces.

Over time there has been a clear shift away from the product-led approach to the strategic-led approach. The Financial Planning method is that process.

Put simply Financial Planning is a way of linking future goals and objectives to short-term decisions. How much should you save? Should you pay down debt? What sort of investment portfolio should you have and what risk should you take?

These types of questions are all answered by viewing them in the context of your goals and lifestyle wishes.

The cash flow software outlined in this document is an important ***tool*** in successfully applying the Financial Planning approach.

About Us

Right from its inception KRD has been a business built around its people, and everyone who works here, from our senior advisory team, to our administration staff, understand that people do business with people, and not with organisations.

Our aim therefore would always be to work very closely with you, because it is vital to us that we properly understand you, and your needs. This helps us to help you to determine, and then achieve, your lifestyle and financial goals and objectives, and in doing so, we can maximise your opportunity to manage, and increase your wealth over time.

Everyone is different and has different needs. Your needs will evolve as your personal circumstances change, so we work with you, to ensure a regular focus on your investments, and pension funds, and to ensure you are advised properly in regard to long-term estate planning, in the most tax efficient way possible.

Many of our long-standing clients have complex financial needs, needs that have changed over time, and which may do so again, in-line with changing financial markets and regulatory frame-works. However, you, like many of our clients, may have neither time, nor easy access to all the information you will need to make informed decisions, and to manage your long term investment finances effectively and efficiently in this evolving marketplace.

We offer a comprehensive financial planning service for all your investment and protection needs:

Pension Planning

When do you want to retire and how much income will you need?

Life Assurance

How much cash would your family need to maintain their current lifestyle if you die prematurely?

Income Protection

Would you require a regular income or a cash sum if you suffered a serious illness or disability?

Investments/Regular Savings

Are you making the best use of any spare capital or surplus income?

Mortgages & Equity Release

Are you prepared for retirement and later life?

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