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THE CASH COW STRATEGY

It's very, very simple. From now on, before you spend any more money on anything, before you jump into an investment opportunity, before you sign a deal for a new car or a new house or condo, before you put another cent on your credit card, before you borrow another dime, stop for a moment and consider the cash flow implications of the thing. Ask yourself these questions:

- Is this a cash cow?
- Is this a cash pig?
- Is there a potential jackpot later on?

If you do this from now on, you will transform your personal finances. You just might find that you'll significantly decrease your stress level as well. If you embrace this concept, it has the power to change your life for the better. I know because it changed mine.

Let me explain.

CASH COWS

If you look up the definition at www.investopedia.com here is what you'll see:

A business, product or asset that, once acquired and paid off, will produce consistent cash flow over its lifespan. This term is a metaphor for a dairy cow that produces milk over the course of its life and requires little maintenance. A dairy cow is an example of a cash cow, as after the initial capital outlay has been paid off, the animal continues to produce milk for many years to come.

That would be a good thing to have, agreed?

Think about the things in your life that provide cash for you on a consistent basis.

What do you think your biggest cash cow is going to be? Your job? Maybe your RRSP? Perhaps your investments? What about a rental property? Maybe you're lucky enough to have a guaranteed defined benefit pension plan—will that be your best cash cow? What about your small business if you are self-employed?

Your answer is so important I'm going to ask you to put this book down, close your eyes and give it some thought. What is the thing in your life that is going to bring in the most amount of cash over your lifetime?

Don't rush this. The more you understand what we are about to discuss, the better off you'll be.

Pull out a piece of paper and a pen. If you have a notebook or an iPad, start your word processor, and write or type the following:

The thing in my life that will bring in the most cash in my lifetime is:

Because I want to give you the benefit of finding out a bit about how you think and how you prioritize things, I'm not going to reveal it to you here. You'll have to wait until the next chapter. Resist the urge to look ahead—it won't be long.

CASH PIGS

A cash pig is the opposite of a cash cow. It is something that constantly drains cash from your pocket. That doesn't mean it's a bad thing. Many cash pigs are useful, sometimes vital, things that many of us can't do without. Can you think of one?

How about a car?

A car is a cash pig no matter whether you buy or lease. It serves a vital function—getting us to work, for instance—but there is no doubt it is a cash pig. It requires cash to buy it whether we pay with a cheque, take out a loan or lease it. There are also all the annual operating costs such as gas and oil, insurance, licensing, repairs and maintenance, etc.

For most of us, the fixed and operating costs add up to thousands of dollars a year. Again, that doesn't necessarily make them bad; it just means they eat up a lot of cash. And of course some of them are bigger pigs than others.

The purpose of identifying things that are cash pigs is not so we can avoid them at all costs. The purpose is to realize how much cash they will cost us so we can make sure we choose one that we can afford and not one that would bleed our bank account dry.

CASH JACKPOTS

Winning the lottery is the most obvious example of a cash jackpot. No doubt about it—in fact, winning millions of dollars or more (tax-free) would be the definition of a jackpot.

But the odds are very long.

The key point to realize is that cash jackpots are rarely guaranteed. They are usually just potential jackpots. But potential jackpots come with a big risk—the risk that the jackpot may not happen at all.

Betting your future finances on a potential jackpot is like playing with dynamite. Don't do it.

But it seems to me that many people spend a vast amount of time (and sometimes money) hoping for a jackpot. The problem is that this opens them up to being ripped off. In *Enough Bull* I talked about simply avoiding any situation that could result in personal financial disaster if it went wrong. I talked about Ponzi schemes.

A Ponzi scheme takes advantage of people who are hoping for a jackpot. It is a scam where the perpetrator convinces people to give them money and in return they'll usually be offered a "guaranteed" high rate of return on their money. In reality the schemer just spends all the money, usually on a lavish lifestyle. The "guarantee" is a lie. There is no such thing as a guaranteed high rate of return.

I now see stories of the latest Ponzi scheme nearly every month. In fact, there were two stories of major Ponzi schemes within 10 days recently in the Toronto newspapers. The dollars lost are staggering—one of the schemes saw $129 million evaporate.

THIS IS NOT A PHILOSOPHY; IT'S ABOUT CASH FLOW

Keep in mind as you read further that we are thinking about the cash flow implications of things so we can make better financial decisions. We are not making a determination about the value or worth of the things.

In other words, we are not making a judgement that cows are good and pigs are bad.

It is also not a philosophical statement about whether things that have the potential for a jackpot are to be avoided. Some jackpots are good and some are not.

It is simply to get you to think about how each decision you make is going to affect what goes in and out of your bank account on a daily, weekly and monthly basis. Note that "cash flow" does not mean just actual cash, it includes all methods of receiving and paying money. That includes actual cash you receive, but also electronic deposits such as your paycheque as well as money transfers from others. Cash you pay out can be in the form of actual cash withdrawals from your account as well as cheques you write and electronic payments and transfers out to pay bills, etc. And of course anything you buy using a credit card, even though it does not have to paid back until later, is outgoing money that affects your cash flow.

Cows and Pigs Can Change

This is also not a permanent branding procedure. Things can, and often do, change characteristics over their lives. A cash pig may become a cash cow later on.

RRSPs would be a good example. As we work and put money into them, they take cash out of our bank accounts, even after you factor in the temporary tax refund you receive for the contributions. They are cash pigs as we make contributions to them.

The payoff comes after we retire. When we start drawing money out of them, they fit the definition of a cash cow. Obviously just how good a cow they are depends on how well our investment strategy worked over the years.

One Person's Pig May Be Another Person's Cow

In some cases the same thing may be a cash pig to one person and a cash cow to another.

Take a gold credit card with a balance owing, for example. The customer pays interest at over 20% on any balance he can't pay off. The bank collects that interest every month. For the customer in this arrangement, that credit card is a cash pig. For the card issuer, it's a cash cow.

Which side would you rather be on?

CASH COW, PIG OR JACKPOT?

There are hundreds of things that we come across in our lives that significantly affect our cash flow. In most cases it is tough to put one label on a thing.

Some cost a lot of money up front, and continue to demand cash year after year to maintain, but they provide the potential for a large windfall gain at the end. That would be a cash pig with a potential jackpot. The house you are likely sitting in comes to mind.

Other items may cost very little up front and provide a jackpot of cash at the end. A penny stock that actually does take off and sells for 1,000 times what you paid is arguably neither a cash cow nor a pig. It's a low-cost bet that pays off—a jackpot.

A cash pig may serve a useful purpose, or it may not. A smoking habit fits the bill as a cash pig without benefits. There is also no hope for a jackpot for a smoker, just years and years of cash drain (and, of course, probably much pain and suffering).

Let's discuss a number of common things.

A House or Condo

What about the biggest asset that most of us will ever own—our house or condo? Well, I have owned three different houses and I can tell you a house is a cash pig.

Again, that doesn't make it bad. In fact, I would argue that a reasonable house that we can afford is one of the best investments we can make. But a home is costly from a cash flow point of view. That is because, just like a car, there is the cash required to buy it (the down payment and closing costs) plus all the ongoing costs such as mortgage payments (including interest), property taxes, insurance, heating and electricity, repairs and maintenance, etc.

While there is little doubt that a house or condo is a cash pig in the years that we are living in it, it has the potential to become a jackpot if we sell it at the right time for more than we paid for it. There is even an added benefit: for principal residences (the one we live in) in Canada, any capital gains are tax-free.

But if you are new to the housing market, you've got to think of the odds of housing profits in the future versus the past before you buy.

Over the last 50 years many people were lucky enough to realize huge gains on the sale of their houses. For example, I know of some houses that were purchased for under $50,000 in the 1960s that are now worth a million dollars. Houses such as this have risen in value by 20 times in 50 years. That's an annual return of 6.2% per year and there is no tax on the eventual sale, assuming it's your principal residence. To make that kind of rate of return in the stock market you'd have to earn 10% or more per year before taxes—extremely unlikely, especially these days.

When we look into the future and consider the demographics of an aging population, it is difficult to visualize growth like that going forward.

Look at it this way: Decades ago, people typically bought houses that were two to three times their annual household income. For example, a family that earned $50,000 would buy a house for $100,000 to $150,000. Now it seems many are willing to commit to buying a house that costs 10 or more times their income. That is not a good idea. Just because prices are rising at incredible rates and banks seem willing to lend excessive amounts of money does not mean you can afford it.

I don't know about you, but thinking about a million dollar house selling for $20 million kind of blows me away. Think of the salary you'll need to afford that. My gut feeling is that the housing jackpots are going to be a lot smaller going forward.

Gambling

While most lottery tickets have a low up-front cost and no ongoing costs that define a cash pig, as I have said, they have only a potential jackpot at the end. The ticket becomes a jackpot if it wins, and an entertainment expense if it doesn't.

But what about those unfortunate souls who get addicted to gambling and can't stay out of the casinos or away from the on-line gambling sites? To them, the habit is not an entertainment expense. Even if they win the odd time, the deck is stacked against them. For some, their habit becomes the biggest cash pig they'll ever have to deal with. Many end up facing financial ruin.

Of course, to the casino, gambling is a cash cow. They can't lose, even if you do. That's because they retain a significant amount of the money contributed. I'd rather own part of a casino than gamble in one.

Personal Debt

Personal debt is a cash pig. For some people, depending on how much of it they have and the interest rate, it can be an absolute cash hog.

But it's interesting to note that a lot depends on what's on the other side of the equation. What was the debt used for? If it was used to buy a reasonable house in which you live, the debt is associated with an asset that you can enjoy, and it may even rise in value and provide a jackpot later on.

If it's consumer debt, such as credit cards and lines of credit that were used to pay for trips and toys you can't really afford, it is a cash pig with no redeeming qualities. The staggering amount of consumer debt outstanding today in Canada is a major risk to the financial stability of our country. Anyone who has excessive levels of consumer debt will tell you it is a cash pig—a cash pig with the potential to bankrupt a person if it can't be paid back.

When it comes to debt it is important to note that corporations are much different than individuals. Most corporations operate under the "going concern" assumption that they will go on forever and never have to repay all their debts. They are, therefore, dependent on the financial institutions continuing to lend them money. But if they are big enough, they have power. The banks can't simply say: "Pay it all back now." If they did, most companies would state the obvious: "If you call our loan, that will put us out of business and you'll get nothing." Or, more likely, they'll just take their loan business to another financial institution.

We as individuals don't have the power that corporations do. We can only get out of debt with plain old hard work to either increase our incomes or reduce our expenses, or ideally both. Of course we may get lucky and win a jackpot and be able to get debt-free that way, but that is one risky strategy that may work for one in a million.

So we see that many things have two sides we need to consider. That's just like basic double entry bookkeeping. Every transaction is not a debit or a credit. Each transaction is both a debit and a credit.

Used wisely, personal debt can and does work. It can bring us the things we want and need. But if it is used to fuel an over-spending lifestyle or take a huge risk on an investment that might (or might not) rise in value, it can be a real financial hog. That hog can, and just might, roll over and crush you.

Defined Benefit (DB) Pension Plans

This is an interesting one. Most people think of a DB plan as a cash cow. But it really depends on the situation.

Basically they work something like this: you work for a company or government for, say, 35 years and you earn 2% of your salary for each year you work—so you are guaranteed 70% of your final year's salary (often the average of your last three to five years) from the year you retire until the year you die. In some cases the amounts are even adjusted for inflation and there may be a survivor benefit so your remaining spouse still gets a percentage of what you used to get—often around 60% or so. Under the typical DB plan, you can't run out of money.

But some plans are funded, to a large degree, by the employer. The employees make little, if any, contribution during their working years. This is the type of plan everyone would like to have—low or no contributions and guaranteed cash for life after you retire. That is a cash cow.

In most cases, however, the employees also have to contribute to the DB plan. One popular plan I looked at recently requires matching contributions—the employer and the employee pay the same amount into it each year. For 2012 the contribution rate for members who plan to retire at 65 was 8.3% for earnings up to the CPP earnings limit of $50,100 and 12.8% for earnings higher than that. That means a plan member earning $100,000 in 2012 would have to pay $10,545 into his or her pension plan—more than 10% of gross pay. Even though the contributions are tax-deductible, that is a lot of money. This plan is a cash pig during the employment years, and a cash cow after retirement.

The lucky people who have DB plans never had to worry about what was in the plan. Those who are trying to fund their retirement with an RRSP do have to worry since there is no guarantee—you could run out before you die if the amount in your RRSP and its future growth are not large enough to meet your spending needs.

That is the problem with RRSPs. They are a defined amount at a point in time—your retirement date. Whether they will be a big enough cash cow for you after that time will depend on how much the investments grow each year versus how much you need to take out each year to feed your cash pigs.

With a DB plan there is no such worry, since the employer is guaranteeing your payments for the rest of your life. Even if you live to 100, you will still get your guaranteed cash each and every month until you leave the earth, unless the company goes bankrupt.

At least that's how they are supposed to work.

The problem is that due to the ultra-low interest rates and the poor stock market returns of the last few years, the entities that do need to worry about what the DB pension plan assets are (that is, the company or government that has to pay out the pensions) are having a tough time growing the assets to a large enough amount to be able to pay the promised pensions.

Many plans are significantly under-funded as a result and this is a major problem for most plan administrators and their members.

Canada Pension Plan and Old Age Security

The government pension plans pose an interesting challenge. As Canadians, whether we are employed or self-employed, we are required to pay premiums to the Canada Pension Plan (CPP). In return, we are provided a pension when we retire—usually from age 65, but sometimes as early as age 60. Is the CPP a cash pig or a cash cow?

You'll find people who argue both sides. I've talked to dozens of them. The answer is that it depends on your circumstances. In other words, how many years you paid into it and how many years you live to receive money out of it. To answer the question, Chapter Eight will detail all the new rules on CPP that are now coming into play. We'll also look at a spreadsheet that you can download for free from my website that will calculate the internal rate of return of your CPP under various assumptions to determine if it's a good investment.

The federal government also just proposed rule changes for the Old Age Security (OAS) pension in the budget of March 29, 2012. The full details will be discussed in Chapter Nine. But what is OAS—a cash cow or a cash pig? Well, since we don't pay into the OAS like we do the CPP (it is paid out of current government revenue and therefore affects the annual deficit, unlike the CPP, which doesn't), it is a cash cow for those of us who receive it. And of course it is a cash pig to the federal government, which has to pay it.

Kids

Parents, like me, realize that our kids are by far the most important things that will ever enter our lives. They transcend money. They provide meaning to our lives.

In fact, I have never met an accountant who did a Net Present Value of the future cash flows calculation before deciding to have a kid!

But let's face it, they cost money to raise. Am I right?

What does that make them?

Well, from a purely unemotional point of view, they are, well, um...

They are cash . . .

Let's settle on "cash piglets," okay?

This book is not designed to help you decide how many kids to have. That is your decision. But seriously, we need to think about what we are spending our money on and how it affects us as well as them. Do they get everything they want whenever they want it? I know it's difficult to resist giving them all the things and experiences we perhaps never had as kids. But what is that teaching them? To expect Mom and Dad to give them whatever they feel the need for at the drop of a hat?

That would seem to be a bad idea from a kid-raising point of view, and secondarily from a cash flow point of view.

Anyway, I'm not trying to give you a sermon here. I'm trying to get you to think about your priorities, giving consideration to the cash flow effects.

A BIGGER VIEW: GOVERNMENT DEBT

Many governments have been incurring deficits (spending more than they bring in each year) and running up debts like never before. Canada is no exception.

The people running the federal government have to deal with a cash pig. The amount of cash required each year to run the federal government is staggering. The annual deficit, or loss, for the year ended March 31, 2011, was $33.4 billion. That is $91.5 million every day, including weekends.

But they have options that we don't as individuals. They have the power to raise taxes. This would seem to be a good way out of debt. But how often do politicians actually do that? Obviously it's unpopular and therefore politicians usually resist doing it until there is no alternative to help balance the budget.

There is also the issue of the connection between raising taxes and the economy. Besides individual voter revolt, there is the effect of increased taxes on corporate profits. Maybe some of the country's most profitable companies might decide to move operations to another country with lower corporate tax rates, taking thousands of jobs and millions in corporate taxes with them.

So the governments tend to continue on the treadmill of not raising taxes, and spending more than they bring in. Who pays for the increasing debt loads? Future generations. They will most likely be saddled with huge amounts of taxes they'll have to pay to avoid future government bankruptcy.

Don't get me started on the subject of debt. I could write a whole book on it. Actually, I already did. It's called *Crushing Debt*.

WHY DON'T PEOPLE FOLLOW THIS BASIC STRATEGY?

So why don't people live their lives focusing on the simple strategy of managing plain old cash flow? Because many of them are looking for an easier way. Many believe that their money problems would disappear if they just were able to find that one investment that would guarantee them a 10% return. Or if they won the lottery they'd be living on Easy Street.

Anything but having to slog away at the office or the warehouse day after day.

Many people are hoping for the day when they will be rich enough to quit work and "retire." They'll try almost anything, even trusting a stranger who promises to make them wealthy.

For most of them, this doesn't work. They never reach their goal. And even for the ones that do, even if they qualify as millionaires, they find out that it's not the answer.

The rest of this book is devoted to getting you to focus on what is important, so you can enjoy your life. It is the better way.