

Episode 4

“If you get wiser you can get rich.”

“I struggle to save money.”

“Whatever you have you will want more.”

“I’ve tried to save.”

“I think I’m pretty good.”

“Going budget for the big ones.”

“I just avoid it completely.”

“I don’t want my kids to end up like me.”

“I don’t think I’m the kind of person who will ever be rich.”

“I don’t know how to handle money.”

“To be honest, it scares me.”

This is “Making Friends with Money” a financial education and money management podcast from Woolworths Financial Services. Giving you the information you need for greater financial fitness is Dr Harry Dugmore, expert in financial behaviour change.

This podcast is all about debt and how to get out of it.

“I first got into debt a couple of years ago and now it just goes downhill. Every year that goes by it gets worse and worse.”

That’s the thing about debt, it often does become a vicious cycle and as one gets in it, particularly when interest rates are running against us, as they have been for the last 18 months, you do feel like you have got into a little bit of a trap and we find more and more every day, you can see it in the papers, repossessions are going up, more and more people are becoming bankrupt. There’s a real crisis of indebtedness out there. So what does one do? How does one approach these debt cycles or just feeling like one’s overwhelmed? Well, the first wonderful piece of news, and it really is the absolute starting point, is that I personally have never seen a bad debt situation that cannot be solved in under 5 years. If you’ve got an income and you know you haven’t gone completely crazy, but even if you owe like hundreds of thousands, and often people owe millions because you’ve got the house and you’ve got the car and you’re maxed out on six different credit cards and the school fees you’re paying on credit as well. Even when people are in a real big jam and they owe substantial multiples of their monthly income, you can generally get out of it in between three to five years without a great deal of pain.

The first thing you have to do (and it's just... you have to get a little bit of order here and you've got to do a little bit of planning) but we're going to in the very next episode of "Making Friends with Money" we're going to look at budgeting and how to make that a pleasure and not the big chore and the, "Oh I hate budgeting". It really can be fun. It can be something that becomes a habit the same way that changing from first gear to second gear becomes a natural.... you don't give it a second thought. We'll look at that soon. But you need to have a really good sense of where the money is going and the reason for doing that is that's the only way that you're going to be able to tell if you can cut back on something.

What can one cut back on? Where could I get an extra R100 or R200 very very quickly and relatively painlessly? And there are a lot of things that come to mind. It's amazing how, if you put your mind to it, how much you can shave off your cellphone every month. I've seen people just by thinking about it, by being conscious about it, halve their cellphone bills. And they say, "Well you know I don't even think I'm making less calls." And the truth is they are but it doesn't feel like such a big sacrifice. And sometimes that's a R300 a month saving and sometimes it's a R600 a month saving, but that's new money. It's like getting a R500 or a R600 increase just by being more conscious about how long you speak for on the phone etc. It sounds like a small thing but it can generate big savings. You maybe downgrade a particular bouquet on satellite TV and you can save a couple of hundred rand. There's now a lot more options that we have. You look at your insurance, I mean people just forget that every year the value of their car goes down in January. You phone in January and you say, "What was my car valued last year and now this year?" and suddenly there's R200 in your pocket that you... a lot of people don't get because they don't just adjust it for you automatically, you have to phone and ask. Very quickly you can get R500 a month, R1 000 a month. And people say, "Wow, that's... I just didn't think of it that way." So one does things like that to discover where the new money is; and quite quickly with your average family. It's not that hard to find, "Oh, here's R1 000." And suddenly there's R1 000 that can go towards paying off the debt. And that's the first exercise – working out where the belt can be tightened.

"I see a lot of people like even if they go shopping then they've got the, you know, grocery list. I just go, like if I've got money, I just, you know, see something and I think 'Oh, I'm short of this' and put it in the basket and... Or sometimes I do have the list in my bag but I don't even take it out. So that's where I overspend, you see."

Once one's identified new money, or savings that you can make, the place to start really is looking at what debt is causing you the most pain. And this gets a little bit controversial because there's two ways of describing that pain. There's two ways of describing the emotional impact. The one is the mathematical way: What debt costs you the most? In other words what debt are you paying the highest interest rate? People often get confused, they say, "You know, my bond is my biggest debt should I attack that first?" No, not at all. It may be your biggest sum of money, but it's almost always got the lowest interest rate. So you look and you look and you say, "Wow that lounge suite that I bought over 4 years, 27% per annum", now that's more than double what you pay on your bond. So clearly that debt is causing you a great deal more pain and distress and it's costing you a great deal more. We're going to target that one first. You start off by putting your debts into a list. Top of the list is the one that is costing you the most interest each month. At the bottom of the list almost always is your bond. And once you do that you use this wonderful cascade methodology. Some people call it the

sort of snowball methodology where you really just hit it one by one by one. You put all the spare money you've now generated by cutting down on your cellphone bills, not buying three magazines, even just cutting back a little bit on the fast food or however you do it, you take all that new money and you put it towards that first debt. And you just go for it until that first debt is gone. And when it's gone the wonderful thing is that you now.... whatever you had to pay on that you can now add – that's why it's call a cascade or a snowball – you can now add whatever went into that debt to your new money. Don't go back and re-sign up for DSTV or suddenly start eating out more, take the R200 or R300 or the R1 000 that was going to that expensive debt, add it to the money that you've saved and now you hit number two. And you go for it and you pay number two as quickly as you can and then when number two is gone, same cascade effect, you've got all the money that had to be paid for number two, because you can't take a break from your debt there's always a minimum amount that you have to pay monthly, but once you've killed number two you move to number three. And typically when people are in a great deal of debt there is usually about seven to ten things on the list. It's not twenty or thirty. I have seen some incredibly sad and complex and challenging levels of debt and I've seen people get out of them in three or four years.

“I would give anything for my debt to be smaller, but I just don't know where to start, but recently I was thinking of paying old debts and not making new ones, but I don't know if that is going to happen.”

I always believe that one should really concentrate on paying the most expensive debt first but there is a school of thought – and I'm sympathetic to it because I very much believe in behaviour change, you know knowledge is not what you need to manage your finances, it's what you do and what we have to do is inspire you to do something different because doing the same thing, even with all the new knowledge in the world, is not going to lead to a different outcome. So the school of thought that says don't tackle the most expensive debt, tackle the smallest one because there's an incredible sense of psychological victory. So if you owe R1 000 but it's not even at a bad interest rate and you owe R10 000, just get rid of the R1 000. You are suddenly going to feel psychologically, “Oh, I had 7 people I owed money to, now it's 6.” And then... So often that's a slightly different way of measuring, of deciding what am I going to pay first. I still like paying the most expensive one first, the one with the highest interest rate. If you're going to get some real satisfaction about knocking off one or two of those smaller ones first, by all means do it. The psychological boost, the 'feel-goodness' of taking out some of those smaller ones even if they are low interest ones, often is worth its weight in gold.

“Making Friends with Money” is a podcast brought to you by Woolworths Financial Services. Go to www.woolworths.co.za/podcast for other podcasts and to find out more about the series.