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Editor's Note

The personal financial debt have been a big concern for many societies and communities, where the credit policy are loosely regulated. Where individuals can easily access to credit for spending on household and personal expenditure, leaving very little balance for periodical saving and investment. It follows that knowledge financial management is very important for both private sector and public sector employees.

The first article on this issue is entitled "Knowledge Management in the Pursuit of Financial Freedom". This article explore the investment setting and see where the Holy Grail is to achieve financial freedom

The second article looks into an agile society. An agile society is one where organisations are agile, whose people are design thinkers, whose reporting structure is integrated and that skills are matched via HR analytics or SWP.

Dr Tan Thai Soon
Editor, *Asian Journal of Knowledge Management*

Knowledge Management in the Pursuit of Financial Freedom – Part 2

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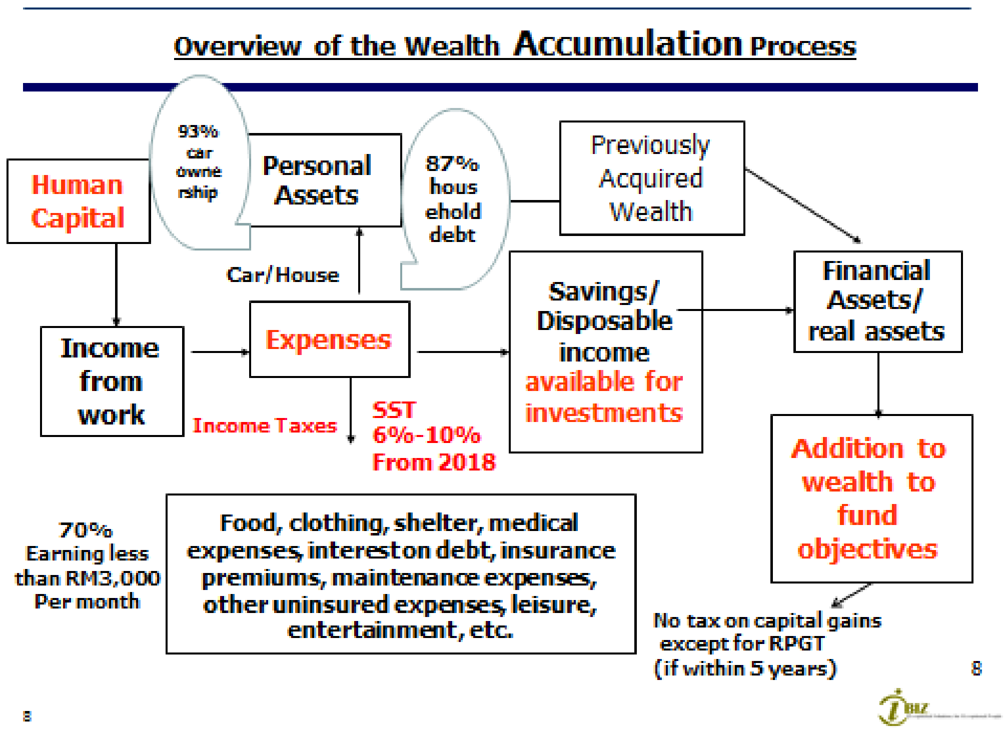
Introduction

In Part 1, I had talked briefly about the seven thresholds of life and financial management beautifully articulated by George S Clason in 1926 through his book “The Richest Man in Babylon.” To reiterate they were:

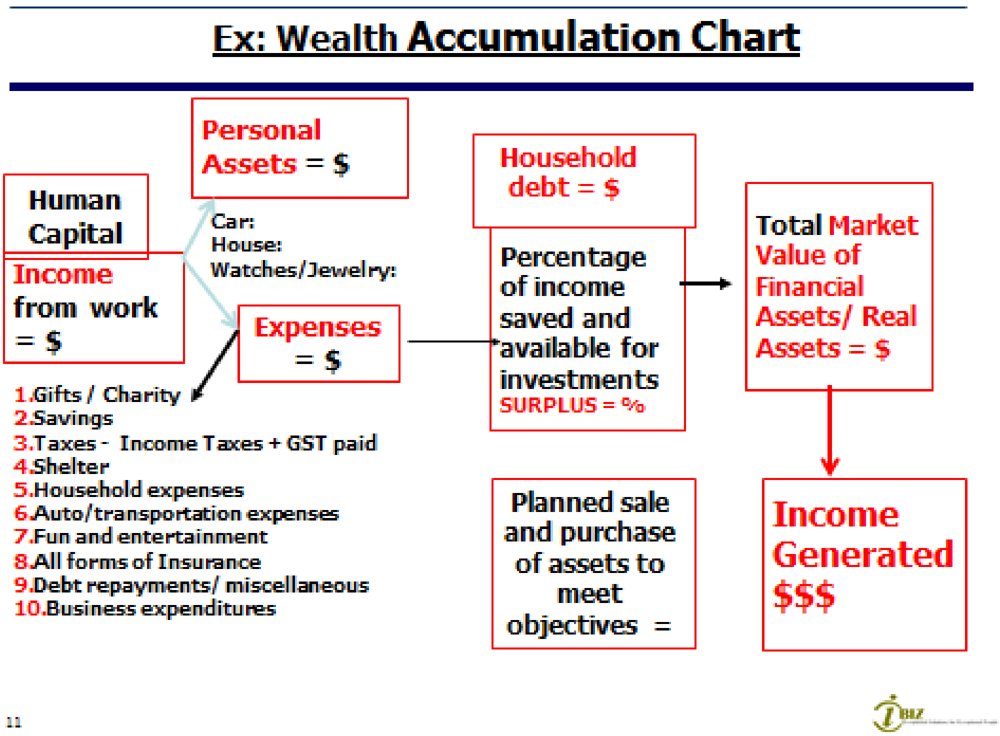
- A part of all you earn is yours to keep
- Control your expenditure
- Multiply your savings
- Guard against losses
- Build or buy your own home and keep your family secure and happy
- Protect your future income – to guard against illness/premature death and your retirement years
- Increase your capacity to earn income or as Steven Covey says sharpen your saw

These seven steps will stand the test of time. Each step has a variety of tiny steps to keep you aligned. Cash flow management was stated as critical to achieving your goal of financial freedom. In this part I will explore the investment setting and see where the Holy Grail is to achieve financial freedom. George Clason was right that the pursuit of financial freedom lies in the personal sphere of: savings, control of expenditures, guarding against losses, investing wisely, protection, and constant attention to increasing your capacity to earn income. Investment is just one part of the whole journey. To think that so much of attention is given to the investment environment and investments does not do justice to the fact that the true quest of financial freedom, lies with the individual.

Let us examine the wealth accumulation process, that is modelled for Malaysians.



From this wealth accumulation process we can know where our major strengths or faults are. It can be refined to calculate your path to achieve financial freedom.



We can identify our strengths and weaknesses. For example if we predominantly squander our surplus income to consumer items like a new and bigger car or house then we sacrifice our ability to channel the surplus income into longer term investments or assets that can deliver future income and capital gains. In the Malaysian context the level of household debt is an indication that households are greatly indebted and mostly on non-investment goods. Houses are required as residence and so in most cases they never become assets for generating future income. But it remains a solid base to build your wealth on. Cars are depreciating assets and so little future value is derived from it. Glitzy items like jewelleries and clothes purchased through credit can be disastrous financially. Credit borrowed to spend on vacations and non-essential goods will reduce your future wealth accumulation. Usage of

Credit card is a big no-no in personal finance especially if balances are not reduced to nil each month.

The expenses indicate how much surplus is generated each month. The 10 basic areas where money is spend on also shows the circumstances you are in. Large families, young families, education expenses and other necessities are different for each family. Leisure and entertainment can take up a huge chunk. Life must be enjoyed but in moderation so that enough resources are allocated to acquire future assets to generate future income.

The quality of your assets and their ability to generate sufficient income in the future is another factor. Assets that generate regular income and also provide future capital gains are recommended. This would be limited to assets like properties and shares. Fixed income assets are good to balance the portfolio so that sufficient income is generated to sustain life as you plan it. You can see the picture already. A portfolio must be constructed that can generate current income and also keep on growing in value. There are two basic needs to be achieved from your portfolio; regular income and capital growth. So a major goal of a planner is to help you construct such a portfolio dictated by your needs and objectives.

It is also evident, that the profession or work you are in, will determine how much income you can generate, which in turn will determine how much resources you can allocate to building your portfolio.

And the job you get and the income you generate depends on your education and how well you can contribute to the welfare of your organisation. We can see now that to mould an individual to have success in life there are so many elements. The home and the upbringing and the values you are taught plays an important part.

From the very beginning in teaching financial planning I have used a chart and had asked the participants, which is easier: you working for your money or money working for you. The answer invariably is money working for you. So if you are earning RM 5,000 a month or RM 60,000 per annum and if you want your money or capital to generate that same income per annum; and, if your comfortable rate of return is 5% per annum, you will require a capital of RM 1,200,000. My next question would be how many of you have that capital of RM 1.2 million working for you. Silence ensues. But herein lies the solution. My target capital needed to generate my income of RM 60,000 p.a., with my 5% rate of return is RM 1.2 million. Now I have a portfolio target – 1.2 million.

I have found that, with a 20 year time horizon, that target is easily reached. Just imagine you owning an investment property worth 1.2 million that has a rental yield of 5%, from which you can derive your RM 60,000 income. So many properties are now hovering around the one million range. However, the black spot is that the rental yield has fallen to 3-4 per cent per annum. So, additional assets are needed to augment your income. But you get the picture. It is not difficult to construct such a portfolio given a 20 years' time frame.

I am already in retirement age, but many are fortunate and have 20 to 40 years still to achieve such a small target. I have designed a simple plan for simple people to use their 20 years to achieve a portfolio of more than 2 million. Let us see how this is done.

Let us assume you are in employment and currently earn RM 5,000 a month. Let us assume you can invest in the National savings scheme (ASB and such similar schemes that can generate about 8% return).

My portfolio will be constructed as follows:

Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

- 1) Contribute the maximum to the EPF tax shelter
  - Employer: Can deduct up to 19% of employee remuneration and have it tax deductible.
  - Employee: 11%
  - There is no tax on the 19% contribution by the employer. It is tax free. It is also tax deductible to the employer.
  - Your personal contribution of 11% of your income is taxed. However, there is a personal tax relief of RM 6,000 against your Total Income. At a 21% tax bracket that is a cash benefit of RM 1,260 p.a.
  - Your EPF account accumulates tax free and when you withdraw it there is no tax on the withdrawal.

KP BOSE DASAN

Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

- 2) Contribute to PRS or Deferred Annuity
- A taxpayer can claim personal tax relief of RM 3,000 p.a.
- E.g. At a tax bracket of 21% (CI above RM 70,000) the cash savings is 3,000 * 0.21=RM 630
- If PRS gives 5% rate of return on the 3,000 contribution over 20 years the Future Value is = RM 99,197... but with your tax deduction, the actual cost is 3,000 less 630 = RM 2,370. Given a FV of 99,197 and payment of 2,370 over a 20 year period the compound annual growth rate= 7.1898% p.a.

KP BOSE DASAN

Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

- 3) Debt reduction especially credit card debt. If there is a balance outstanding the interest charged is a minimum of 18% and with late payment penalties it may exceed 20%.
- Which investment gives you that return?
- Every ringgit in debt paid saves you 18%.
- However, if you own the bank or credit card company or earn heavy commissions from issuing it, it is best to stay neutral.

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Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

- 4) A good leverage debt. Invest into ASB for e.g..
- E.g. Borrow RM 200,000 say at 6%. Over 20 years the monthly repayment is RM 1,432 p.m. Let's assume the RM 200,000 invested in ASB is growing at a compound rate of 7.5%p.a. This will give a future value of RM 892,163.
- In summary, the total payments to the bank =

  [12*1,432 *20] = 343,680.
- Therefore there is a net gain of RM 548,483. [892,163 – 343,680]. Half a million accumulation, free... over 20 years.
- Two members in a family utilizing this method will derive a net gain of over RM 1 million.
- However caution is required. 1st assumption you can get a loan for RM 200,000. 2nd assumption ASB/ASM can give you compound annual return of 7.5%. 3rd assumption – you reinvest the dividends to derive compounding effect.

KP BOSE DASAN

Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

- 5) Invest in an affordable rental home.
- E.g. price of house=RM 300,000. Down payment 10%=30,000. Loan 270,000 over 20 years at 6% p.a. monthly rest. Monthly payment=RM 1,934.
- Future value of house at just 4% appreciation p.a.= RM 657,336.
- Let us assume that rental yield is only 4% = RM 1,000 per month. (It is more likely to be RM 1,500 per month) Therefore, your actual cost of mortgage is RM 934 [1,934 – 1,000].
- Re-working the numbers: FV of house is RM 657,336. N=20 years, Payment = RM 934 pm or RM 11,208 p.a. Your actual yield is 10.2% end mode. Using your initial down payment of 30,000 Annual payment of 11,208 and a sales value of 657,336 your IRR=8.055%. That's a very good return over 20 years. Better circumstances will produce better results.
- In nominal terms: Total payment = 11,208 * 20 = 224,160 + 30,000(DP)=254,160
- FV of house=657,336 Net Gain= RM 403,176.
- Two members of the family and two similar circumstances means an accumulation of RM 806,352.
- List the assumptions taken in this example.

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Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

6) Build a portfolio of stocks.

- Decide to acquire at least 1 stock per month. After 24 months you would have 24 different stocks. Your diversification is as good as a billion dollar fund. The remaining 18 years you build on this portfolio either adding to the existing portfolio of 24 stocks or adding value stocks along the way.
- e.g. Today one lot is 100 shares. Therefore, every month at an average price of RM 5, you need to invest RM 500 each month. With an average growth rate of 8% p.a. the FV of the stock portfolio would be= RM 294,510.
- Assuming a dividend payout ratio of 3%p.a., (focus investing on dividend yielding stocks of at least 3%) the yield will be 11% p.a. The FV would therefore be = RM 432,819
- In summary: Total payment= 6,000*20= 120,000
- Total value = 432,819 Net Gain= RM 312,819

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Life Cycle-Planning: 25 – 45 Age Group

Best things you can do with your limited money!

Summary of Expenditures:

1. EPF – mandatory contribution
2. PRS – RM 3,000 p.a. – RM 250 p.m.(Yield of 7.18%) After tax cost=RM 198
3. Personal Debt reduction – as per circumstances (possible 18% saved on credit card debt)
4. ASB investment – RM 1,432 paid to bank (FV net benefit= > half a million)
5. House purchase= RM 934p.m.
6. Stock investment – RM 500 p.m.

- Total monthly cash flow= 198 + 1,432+ 934 + 500 = RM 3,064 p.m. Annual= RM 36,768
- Total Value of Assets (20 years): PRS 104,158 + ASB 892,163 + House 657,336 + Stocks 432,819 = Grand Total of RM 2,086,476.
- Total Portfolio return of 9.92 % p.a.

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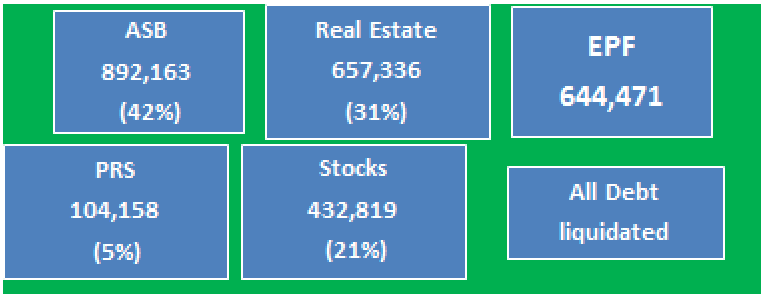
Portfolio Allocation – after 20 years

Total Value= RM 2,086,476 (excluding EPF)
IRR of Portfolio : 9.92 % p.a.



Critical to financial planning is the asset allocation strategy after the 20 years. During the 60-80 age stage regular income is important. We have to restructure the Portfolio to produce the required income and still place sufficient assets into growth. The income need will determine this. Many will sacrifice return for safety of principal.

KP BOSE DASAN

Now you realise that a target of 2 million is not that difficult. Many participants in my seminars will ask that, if they allocate RM 3,000 a month out of RM 5,000 income how will they live or survive. That is a good question. Being realistic, your program needs to start slowly at first and then gather momentum. In the early it may be very gradual, but soon it will gather speed.

Why is it possible to achieve an Internal Rate of Return of around 9%. The answer lies in the tax benefit given to most of these investment modes. As a tax consultant my approach is to utilise all the reliefs given in the tax statutes. Take EPF for example. Not only is your EPF contribution by the employer fully exempted, the employee contribution also enjoys a relief, and the returns earned by EPF and distributed later by EPF is also exempted. The same applies to PRS. There is also a National Education Savings Fund that gives tax exemption. So there is plenty of room to achieve a modest wealth accumulation and live quite comfortably. It requires as usual discipline, patience and most importantly re-investment.

To go back to George Clason and the richest man in Babylon story, savings patiently and consistently tucked away from monthly income, losses avoided from greed and scams and withdrawals kept to a minimum will enhance your chances of financial freedom. Needless to say you must build a portfolio larger than just your retirement income as there may be many more objectives that you may have. There are many tricks up the sleeves of financial planners and it pays to consult them and get more details on strategies and the right mix of financial and investment products.

Conclusion

It looks like the quest for financial freedom has to have a few more parts. The volatility of investments and hedging the impact of inflation requires more knowledge. These issues will have to be taken up in my next assignment

Article by KP Bose Dasan tax and financial planning guru who believes that education is the key to doing the right things but courage to take risks and the capacity to save to accumulate investment capital are equally important in achieving financial freedom.

Agility for Today's Organisations

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Abstract

Agility is needed for today's society as organisations in Malaysia are stuck in the mud when it comes to innovation and creativity. They do not have the structure to be able to flexible, manage change and deflect negative impact of a volatile external and internal economy. A reporting system in an agile organisation should be integrated.

Key Terms: Agile, integrated reporting, strategic workforce planning, design thinking.

An Agile Organisation

In Malaysia, organisations are often mired in bureaucracy and shades of gray in the way they carry out processes. What should be introduced is agility within organisations. However, many do not know what an agile organisation is.

In agile organisations staff are organised into teams instead of budgets. Their work is very often aligned with a mission and value added strategy that is to cater for a market segment or a product. An agile team is cross functional and the members of the team have all the competencies to transform the organisation. An agile team is co-located which means that executives sit physically together to maximise communication and collaboration.

Members are fully dedicated to the team. Agile teams are stable and do not require frequent shuffling of staff around. Agile teams decided together how to work, how to solve problems, who works with who and in which order work is done. Within the boundaries of their mission they determine the best strategy, the team owns and shape the processes and have collective responsibility for the product quality and services that the team delivers (Janlén 2016).

Very often in an agile organisation the boards of directors provides clear guidance and support to the teams. Each teams govern themselves and makes decisions on a daily basis and in order for them to facilitate this the vision must be clear so that goals are aligned to them. Teams are empowered and trust to perform accordingly to priorities established. Managers provide feedback and guidance to teams when it is requested. When teams find areas to challenging they request help and support from their managers e.g. new tools and systems, new ambience and environment like chairs and plants to make the room nicer, better training to cope with new work, and finally protection from stakeholders who tend to pry on their jobs. Teams will also establish dialog with other people and ask for help to get connected with other teams, or to try to understand stakeholders and their needs. Teams need to know what their customers want and know what their external partners require which can be complex (Janlén 2016).

Should an organisation be large each department would normally have 150 staff and have value stream or product teams. The managers would group teams that are dependent with each other. One structure is to have a forum e.g. architecture strategy, joint deliver process and work environment. Each team would send a representative to each forum to ensure that all perspectives are included in the dialog (Janlén 2016).

Integrated Reporting

Moreover agile organisations require a reporting structure akin to one that is integrated. In today’s shelf life of a company it is reduced from 50 years to around 15 years and most start-ups lasts only 5 years in terms of profitability. Thus, it is important that companies adopt a system of reporting that is integrated in order for the board of directors to gauge the health of the organisation in a thorough and vivid manner. Investors need the right information from organisations and companies are too engrossed in compliance measures. The tremendous focus on financial information only serves to worsen the myopia in capital markets (ACCA 2017).

Like the agile discipline there needs to be stronger dialog between the board of directors and investors. Integrated Reporting (IR) is strategic communication is how organisations draw on relationships and resources available to them. The objective is to create value over time. IR identifies 6 capitals that are important in the reporting framework i.e. financial, manufactured, intellectual, human, social and relationship, and natural. Business impact on the different capitals and determining the strategy based on the former is what agile organisations require. This leads to better informed decisions and better management or risks. When this is clear, opportunities present themselves to C-suite management on what to do (ACCA 2017). Business is based on trust between the various stakeholders and the sooner society moves organisations towards IR the better is the outcome.

Strategic Workforce Planning

An agile organisation has to have some form of HR capacity planning in to have a strategic work force. To inculcate strategic workforce planning (SWP) means an organisation needs to have the right people in teams, the skills have to be updated continuously, timing in which things are done are right, plans have to be correct and that costs are acceptable and within reason (D'Onofrio 2018).

Technology is the key driver in talent acquisition. With SWP it is also a people and process change within the organisation and because line manager focus so much on their own functional priorities they forget that they have to work in line with HR. Analytics within and outside the organisation are required to source for talent that matches skill sets that the job needs and the cultural fit warranted by most companies. Technology is the driver of change in an HR sense within an organisation (D'Onofrio 2018).

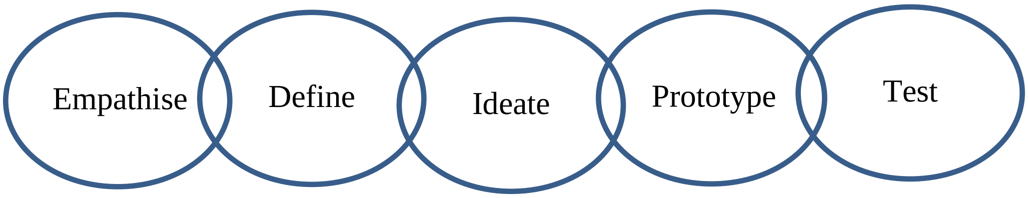
Internal data sources come in the form of information on salaries, benefits and training that workers have attended, skill sets and what training has to be carried out to fill the skill and experience gaps. Thus, a profile of the required worker is designed and drawn out with the help of managers in the organisation. External data sources derive from social media, job agencies, universities and governments (D'Onofrio 2018).

AI assist SWP by assisting the company to acquire and process internal and external data sources in a must faster way. Analysts can deduce and induce clean data patterns that are constructed to form models either designed by both humans and machines. In order to adopt SWP organisations have to change in the way things are done preferably in an agile way. The HR and business functions are required to transform (D'Onofrio 2018).

Design Thinking

One of the skill sets that a modern employee of an agile team needs to have is design thinking. Design thinking is where a worker is required to empathise with both internal and external customers. Fitting their needs is one thing but delighting them is another and very often required to sustain and maintain their loyalty as most marketers would recommend.

Via interviews and observations one can define (See *Figure 1*) the non-obvious insights garnered from customers. From that the analyst should ideate and brain storm solutions. Next with the assistance of data engineers and scientist build a minimum viable product or service in other words a prototype useful for the organisation. After which ask your internal or external customers what they think about the prototype. If the analyst had asked customers what they wanted, they would have replied low cost product and services. But with design thinking and empathy, one could add value to products and services that not only satisfy but also delight customers. Product price would have been higher but customers would have been happy and rise in profitability substantiated (The Strategy Group 2017).



(Figure 1)

Design Thinking - The 5 Stage Process

Conclusion

An agile society is one where organisations are agile, whose people are design thinkers, whose reporting structure is integrated and that skills are matched via HR analytics or SWP. We know in the modern world skills training is continuous and that old jobs are being replaced by automation and AI. However what is still required by customers within and outside organisations is the ability to innovate and create value added products and services that delight them. With this in mind an organisation is able to sustain and be profitable for an extended period of time without concern for falling productivity and profit margins that ultimately spell the demise of a start-up or company. This article above serves to answer some of the hurdles that face board of directors, C-Suite managers and HR practitioners time and time again.

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