Budgeting

Use Money Wisely

CONTENT NOTE

Financial Education
FROM POVERTY TO PROSPERITY

To take control of your money, be aware of how and where you spend it, and give it more purpose.[1]

Definition

"A budget is a plan that lays out what you will do with your money."[2]

A budget is a fairly simple tool that anyone, rich or poor, can use to manage money. A budget serves as a master plan for the future. Budgets are a road map that can help you get from where you are now to a financial goal down the road. Financial goals can be short-term, such as getting out of debt, meeting day-to-day expenses without borrowing, paying school fees, or saving for a special need or desire. Goals also can be long-term, such as saving for a house or retirement. Making a budget will help you allocate your resources to meet multiple goals.

You can do three things with your money: spend it, save it, or invest it:

- You spend money for day-to-day needs such as food, housing, transportation, clothing, healthcare, debt repayment, and discretionary expenses such as tea, movies or vacations.
- You save money for unexpected emergencies, unexpected opportunities, or to meet short- and medium-term financial goals.
- You invest money in business ventures to earn income over the long-term.

[1]Griffith, William C., *Bill Griffith's 10 Steps to Financial Prosperity*, Probus Publishing, IL, 1994.
[2]Godfrey, Neale, S. and Caroline Edwards, *Money Doesn't Grow on Trees, A parent's guide to raising financially responsible children*, Children's Financial Network/Fireside. NY. 1994.

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The best advice for how to manage these three parts of your financial life is simple to say but harder to accomplish:

Spend wisely,
Save regularly,
Invest prudently.

These are the fundamentals of money management. A budget will help you allocate your money across these three categories and make your daily money decisions a little easier.

"A good budget helps you to pay for what you need and save up for what you want."[3]

BUDGET BENEFITS

A budget:

- Eases decision-making about spending and saving
- Encourages cautious spending
- Encourages disciplined saving
- If followed, helps you to meet financial goals
- Helps you take control of your money

How Do You Make a Budget?

1. *Keep track of your income and expenses*

The first step is to keep careful records of the money coming in to your household (income from all sources) and the money going out (expenses). You can then use this information to create a *cash-flow statement* that shows where your money comes from and where it goes during a specified period of time. In other words, it tracks the *flow* of your income. Analyzing your cash-flow can help you figure out whether your expenses are greater than your income. It will help you identify where you can cut back on spending and ways you can save more (Gardner and Gardner 1998).

To make a cash-flow statement, select a recent time period—a week or a month—for analysis. List all your sources and amounts of income during this

[3]Godfrey, Neale, S. and Caroline Edwards, *Money Doesn't Grow on Trees, A parent's guide to raising financially responsible children*, Children's Financial Network/Fireside. NY. 1994.

period. Your *total income* should include any of the following types of income that pertain to your household: your salary after all deductions, average business income, spouse's income, other household members' incomes, rental income, remittances and any other sources of income. If you have a source of income that comes in only periodically (e.g. quarterly, or twice a year), you can estimate how much it amounts to over one year, and divide by 12 to determine how much this income would be on a monthly basis.

Next, list your *expenditures*, including necessities (food, housing, clothes, transport, etc.), debt repayments and discretionary or optional expenditures. Do not include extraordinary or one-time expenses, only those expenses you typically have during this period.

Finally, subtract the total expenditures from the total income. The result is your *net income*—the difference between your income and expenses during the period. In the sample cash-flow statement in Figure 1, Josephine has $35 at the end of the month that she can decide to save, invest or spend.

Repeat your record-keeping over several periods (weeks or months) so that you can identify the differences between periods and come to know the fluctuations in income and expenses. When are you likely to spend more money than you have coming in as income? When is your income higher? Can you save more during those periods? When are your expenses higher? What irregular expenses do you have? Are these necessary expenditures?

FIGURE 1:

JOSEPHINE'S CASH-FLOW STATEMENT
NOVEMBER 2003

	Amount
THE MONEY JOSEPHINE MAKES	
Business income	
Kiosk	$200
Used clothes sales	$300
Farm income	$175
Husband's casual work	$200
Rental income	$50
Remittances	$75
TOTAL INCOME	**$1,000**
THE MONEY JOSEPHINE SPENDS	
Necessary Expenses	
House rent	$300
Utilities	$45
Food	$150
Transportation	$25
School fees	$75
Medical expenses	$50
Clothing	$20
Sub-total	**$665**
Discretionary Spending	
Video rental	$32
Ice cream	$18
Church offering	$80
Sub-total	**$130**
Debt Repayment	
School tuition	$35
Bank loan	$85
Moneylender loan	$50
Sub-total	**$170**
TOTAL SPENDING	**$965**
NET INCOME (income - spending)	**+$35**

2. Create budget categories that are appropriate for you

Once you have estimated your monthly net income (Step 1 above), the next step is to think about appropriate categories for your budget. You must decide how specific or general to make each category. Keep it simple. The two most basic budget categories are spending and saving. Figure 2 shows some of the specific items under each of these categories.

FIGURE 2: POSSIBLE BUDGET CATEGORIES

Spending	Savings
▪ Necessities (rent, school fees, health, utilities, food, insurance, transportation, clothing, ROSCAs) ▪ Debt repayment (loans, hire purchase, other debt) ▪ Discretionary expenses (entertainment, charitable contributions)	▪ Emergency fund ▪ Short-term savings ▪ Medium-term savings ▪ Long-term savings

3. Set your financial goals

Goals can vary—from meeting basic needs, to getting out of debt, to educating children, to buying a house. Some are short-term to be accomplished quickly, others are long-term. Once you decide on your priority goals, figure out the cost of each and set a time frame for achieving it. Next, estimate how much you must allocate to savings every month to achieve each goal. If this amount is more than you think you can afford, make adjustments—extend the time you need to save the desired amount, reduce the cost, or change the goal.

Figure 3 provides an example of financial goals. Comparing the amount that Josephine wants to save each month towards her short-term goals (Figure 3) to

FIGURE 3: JOSEPHINE'S SHORT-TERM FINANCIAL GOALS

Goal	Cost	When?	Savings/Month
1) House Repairs	$180	12 months	$15/month
2) School Fees	$320	8 months	$40/month
3) Son's Operation	$160	4 months	$40/month
TOTAL SAVINGS NEEDED PER MONTH $95			

the amount she has available for saving (Figure 1), a shortfall is evident. With her current income and expenses, Josephine cannot save as much as she wants to each month. She can adjust her savings goals, saving less for each specific goal and extending the time it will take her to accomplish them. And, she can look hard at her expenses to find places to cut down in order to free up more of her income for saving.

4. Allocate your income across your budget categories

If your cash-flow statement provides a good and detailed estimate of your current income and expenditures, you should be able to identify opportunities to reduce spending and save more. When you allocate money across budget categories, consider your priorities and financial goals. If, like Josephine in the example, you don't have enough income to pay for daily necessities, repay debt *and* save for specific goals, you know that you will need to make adjustments in the budget. You can reduce your price expectations (for example, use less expensive materials to repair your house) or extend the time for achieving your goals (give yourself 18 months instead of 12 months to save for house repairs). Be realistic. See Figure 4 for an example of a budget allocation.

FIGURE 4: A SIMPLE BUDGET ALLOCATION

Spending		**Savings**	
Necessities (housing, food, etc.)	60%	Emergency fund	10%
Debt Repayment	10%	Short-term savings	5%
Discretionary expenses	10%	Long-term savings	5%
TOTAL SPENDING	**80%**	**TOTAL SAVINGS**	**20%**

What Other Factors Will Influence Your Budget?

1. Your money beliefs

Beliefs about money are based on what we have seen, heard, and experienced in the past. We build our behaviors on them. However, some common beliefs about money are not accurate and they hold us back unnecessarily. For example, many of us believe that we cannot manage money well because we are not good at math (Pohl 2001). Figure 5 offers some common beliefs about money. Can you think of any others? What are some of your personal beliefs about money? What ideas about money or cash or banking are common in your area or particular to your ethnic group?

FIGURE 5: RATE YOURSELF: TRUE OR FALSE?

- Managing money is complicated
- A person needs to be good at math to be good with money
- My friends would leave me if I earned more money than they did
- It takes a lot of money to invest
- My debt is too big to do anything about it
- I trust my husband to make good choices for me
- Poor people cannot save money

2. Your money personality

Your past behavior in managing money is a reflection of your money personality. Are you a hoarder? A spender? A money avoider (such a person may spend easily but understand little about money)? A money amasser? A risk taker? A risk avoider?

Most people are a blend of more than one personality. Knowing your "personality" can help you counteract tendencies that may get in the way of achieving your financial goals (Godfrey and Edwards 1994; Pohl 2001).

3. The "financial phase" of your life

The amount of money coming in and amounts you allocate to spending, saving, or investing varies at different stages of life. When you are young, you will spend most of your money, but as you reach middle age, you will be able to save more. If you are over 65, falling income may force you to save less and spend more. When you make a budget, think about the financial phase of your life. In designing financial education, consider common patterns in the financial phase of life among your clients.

Nothing Ever Stays the Same—Your Budget Will Change!

Over time, changing circumstances may require you to revise your budget. If your income goes up, you can allocate more to savings. If your income goes down, you may have to save less in order to pay for basic necessities. If you have another child, you may decide to save more for education. If the price of basic needs go up at a faster rate than income, your budget will need to be adjusted. Monitor your budget regularly so that you are prepared to adjust it in response to your changing circumstances.

Budgets will also sometimes fail. Failure is generally due to (1) a serious emergency (a natural disaster or sudden illness) that forces unplanned spending; (2) lack of commitment or self-discipline; or (3) unrealistic goals. For emergencies, you can protect yourself against the negative impact of unexpected events by creating an emergency fund that is part of your budget. As you learn about and understand money and finances, you will be able to set more realistic financial goals and find the self-discipline to achieve them.

How Do You Stay Within Your Budget? Discipline!

Making a budget is a simple task. Anyone can do it. But following a budget, and sticking to it, can be much harder. It takes discipline! You must respect each part of the budget, from establishing financial goals, to controlling your spending, to honoring your commitment to save. The following guidelines will help you find the discipline you need for each aspect of your budget.

FOR SETTING FINANCIAL GOALS:

- Set specific short- and long-term goals for your money.
- Set up at least one goal that you can reach quickly to reward yourself for saving.
- Review your financial goals and budgets over time.

FOR SPENDING:

- Reduce what "goes out" as a key form of saving (Rutherford 2000). Wise spending helps you save.
- Make a list of all the possible ways to spend less on daily expenses. You can save more over time by cutting back on regular day-to-day expenses than by cutting back on one big-ticket item.
- Keep track of how much you spend on everything.

FOR SAVING:

- Save first! Follow the 10 percent solution—save 10 percent of what you earn. One strategy is to save first and then think about how to spend what's left over. Easier said than done, this strategy is a good way to achieve your financial goals.
- Save 3–6 months of operating expenses in an emergency fund before you allocate saving for other purposes. This will protect you in case of family illness or unemployment and reduce your reliance on short-term debt to meet emergency needs.

- Keep savings out of reach. If you keep your savings at home, you are likely to feel pressure from your family members to spend that money.

FOR INVESTING:

- When you are considering an investment, identify the nature and psychology of its associated risk. You can think about risk as a matter of chance, and ask, "What are the chances that I will make a big profit or suffer a big loss?" But a second aspect of risk is much more important, "What are the consequences of taking this risk?" In other words, what will happen to me if the investment fails?
- Figure out your tolerance for risk. Remember other occasions in your life that involved taking risks. How did you handle those? How did they make you feel?

References

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