



UNIT 2 – 3

Budgeting for Success

In his book, The Millionaire Next Door, Tom Stanley presented the results of his study of millionaires in America. Dr. Stanley found that the habits and value systems of millionaires were quite different from what most people believe. When you think of a typical millionaire, what is the image that comes to mind? People with big houses, new cars, fashionable clothes, and all the latest electronic gadgets?

Actually, Dr. Stanley found that most millionaires don't fit that image at all. The typical millionaire lives in a middle-class home, drives a car that is at least two years old and is paid for, buys jeans at Wal-Mart, and most importantly, lives below their means. Many millionaires work as welding contractors, auctioneers, rice framers, owners of mobile home parks, pest controllers, and paving contractors. They have a net worth of \$1.6 million, however, they live on less than 7% of their wealth. Most millionaires are homeowners (97%). More than half of them have lived in the same home for more than 20 years.

Millionaires are also a well educated and hard-working group. Four out of five millionaires are college graduates with many of them having advanced degrees – 18% have master's degrees, 8% law degrees, 6% medical degrees, and 6% have PhDs. More than 80% of millionaires did not inherit their money – they earned it by working an average of 45 to 55 hours per week.

So, what does all of this information about millionaires have to do with you? By evaluating your financial situation, developing a plan to meet your financial goals, and implementing a planned budget, you too can be well on your way to accomplishing your financial goals.

Case Study Application

In this lesson, we will be examining the importance of financial planning. As we go along, we will examine the following case study which continues to feature Matthew and his travels along the financial pathway to home ownership.



CASE STUDY: MATTHEW FURTHERS HIS GOALS

Matthew is currently a high school junior. He enjoys school, but is looking forward to the day when he can get out and have his own home and make his own decisions. He has been examining different potential occupations featured in the Occupational Outlook Handbook from the Bureau of Labor Statistics. Based on his interests and the median salaries for many possible occupations, he begins to question if he can afford the lifestyle and home he desires.

Matthew decides to select several occupations and create potential budgets for each of the occupations. As he sits down to create a budget, he wonders how to best set up the budget and how to determine the categories for it. He wonders if he will be able to afford to purchase his own home when he completes his college degree and heads out to his first job.

The Importance of Setting a Budget

Good money management consists of three important components: setting priorities, establishing a plan, and following the plan. Before establishing a budget, you should ask yourself what your spending priorities will be. What percentage of your income will you put into savings or investments? How much will you give in charitable contributions? Will you drive a dependable used car or a new luxury car? Will you live in an apartment with friends or at home with your parents? What are your goals for your money?

When examining your spending priorities, you will want to consider that a certain percentage of your income will be spent on **fixed expenses**, or expenses which do not vary much over time such as housing, food, telephone, car insurance, etc. You will also have many **variable expenses** where you will make choices among various options such as eating meals at restaurants, purchasing new clothes, or giving gifts to friends or even making charitable donations. Many of your variable expenses will be for non-necessities like entertainment and recreation, and so the amount of money you spend on them is likely to vary considerably over time.

Knowing your income and expenses is a good place to start with your budget, but the most important thing is that you set your goals and put them into writing. Motivational speaker Brian Tracy's research supports this. In a study of Harvard graduates, after two years, the 3 percent who had written goals achieved



more financially than the other 97 percent combined!¹

- What other expenses might you want to include in your considerations?
- Take a few moments and write your financial, educational and career goals.

Setting Your Budget

For many people, money management can be a difficult task. Nevertheless, successful money management begins with three basic steps: setting priorities, establishing a budget or spending plan, and following that plan. You will also want to review your plan periodically to see if there should be any changes or modifications. You will find if you write out your budget on paper, you will be more successful than if you just keep the budget in your head.

The first step in setting your budget is to set your financial goals. Think about your values and how you can match your money with your lifestyle and goals. Now, collect all of your financial information and statements such as bank statements, investment accounts, utility bills, credit card bills, telephone bills and any other information concerning income or expenses. The more information you have, the better your budget planning will be.

Now that you have collected your documents and other financial information, start with a summary of your *income* because you will need to know how much money you have to work with in your budget. If you are self-employed or have any other sources of income be sure to include those as well. If your income is in the form of a monthly or period paycheck where the taxes are automatically taken out, the **net income**, or take home amount is the amount you will use for your budget. If you are not yet employed, you could use the Bureau of Labor Statistics [Occupational Outlook Handbook](#) to research your possible career choice. The [Handbook](#) includes median salaries for all occupations and you could use one of these salaries to create your budget until you have firm numbers for your job. The [Handbook](#) is available at: <http://www.bls.gov/oco/>.

The next step in your budget is to estimate your *expenses*, starting with your monthly fixed expenses. Your financial records should be a good source of information for estimating these expenses. This will include expenses such as your mortgage or rent, car payments, cable and/or internet service, trash pickup, meals away from home, groceries, credit card payments, etc. These are expenses that are essential and not likely to change in the budget.

Next, review your variable expenses. Collectively, these expenses are important because many of them can be trimmed or entirely eliminated from your budget if necessary.

¹ Brian Tracy, <http://www.briantracy.com/>
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Now that you have your income and your total expenses, compare the two to see if they balance. If your income and expenses don't balance – which often happens – you will have to decide where you can make adjustments to the budget. If your income is higher than your expenses, you should consider additional savings or investment goals. In contrast, if your expenses exceed your income, you will need to make some changes to bring them in line. You may want to do the following:

- Reduce expenses – this is the option that can make the quickest and biggest impact. Review your expenses to determine if they are needs, wants, or desires. Examine where your money is going and ask yourself which expenses can be eliminated. Or, perhaps you could find cheaper alternatives? For example, instead of purchasing a print copy of the newspaper, could you read it online? Instead of buying coffee on the way to work, could you brew some at home and take it with you? Could you watch your favorite shows online instead of through cable television? Could you use public transportation in place of having your own vehicle?
- Adjust debt payments – if you have debt, contact your creditors and see if you could adjust your payments and/or interest rates. If you choose to go with a nonprofit consumer credit counseling agency, ask questions about fees and procedures before signing anything! Make sure you are getting what you are paying for rather than just creating a bigger problem.
- Increase your income – consider taking a new or second job to pay your expenses. If you have invested in your education, this can increase your earning potential. Brainstorm ideas for increasing your income.

You will find that small changes in your budget can have a large impact when they are all added up. Be sure to review your budget monthly to make sure that you are staying on track. Each month compare your income with your actual expenses, and then compare your actual expenses with your estimated expenses. This will give you a good idea of how well you are following your budget and improvements that you may need to make.

Your plan is likely to change as your lifestyle changes so you will want to make adjustments as you go along. It is also a good idea to set up a budget every month to better help you track and restrain your expenditures.

- What other budget saving suggestions do you have?
- How can you make small changes in your behaviors so that they will have a desirable impact on your budget?



Sticking With Your Budget

Now that you have written financial, educational, and career goals, and now that you have created a budget, the challenge is to stick with it. With 70% of people living paycheck to paycheck, and 80% of graduating college seniors having credit card debt before they even have a job, it is essential that you stay focused on your budget and your goals.

Dave Ramsey in his book Total Money Makeover recommends that you allocate the following percentages to each category in your budget:

- Charitable Gifts 10-15%
- Saving 5-10%
- Housing 25-35%
- Utilities 5-10%
- Food 5-15%
- Transportation 10-15%
- Clothing 2-7%
- Medical/health 5-10%
- Personal 5-10%
- Recreation 5-10%
- Debt 5-10%

These categories and weights may serve as good guidelines when you work up your own budget.

It is also important to include a savings portion in the budget. This savings can help you to meet long-term savings goals as well as serve as a cushion if the unexpected happens, and we all know that the unexpected can and usually does happen! By having a savings cushion, this allows you to make accommodations and not have to go into debt for them.

The biggest part of maintaining your budget will be staying focused on your goals. In a recent Forbes magazine article that interviewed the richest 400 people in America, 75 percent of those interviewed said the best way to build wealth is to become and *stay* debt-free. Living within your means and focusing on your goals will lead you along the pathway to home ownership and more importantly financial well-being.

- What are steps that you can recommend to Matthew in this unit's case study for maintaining his financial well-being?
- What can you do to stick with your budget? How will this assist you with your financial, educational, and career goals?

