By Linda Leitz

Educated budgeting

Budgeting is sometimes a vital part of financial planning, even though it can seem pretty basic and rarely draws on the full scope of a CFP's expertise.

Budgeting isn't an issue only for those with lower incomes. Households with healthy balance sheets and high incomes may squander their resources, while some with small incomes save enough to meet their financial goals. Clearly, budgeting is about more than having enough money. Discipline and the willingness to set in place patterns of behavior have as much impact as the actual dollars available.

For consumers to improve their budgeting, they must be open to making changes. Academia offers models for behavioral change. A look at how NAPFA members work with clients on budgeting suggests how actual budgeting strategies fit into the academic model.

Academic ideas on behavioral change

The transtheoretical model of change—explored by James Prochaska, Carlo DiClemente, and John Norcross—proposes that there are five basic stages to how people change: pre-contemplation, contemplation, preparation, action, and maintenance.

People in the pre-contemplation stage aren't thinking about making changes. It's not even on their radar. In the contemplation stage, they realize that change might be helpful, and start to think about modifying their behavior or situation. At the preparation stage, these folks start doing research, look at their alternatives, and set up their life and thoughts around altering their behavior. Next, they take action. And, once they've taken action and effected a change, they continue maintenance of their new thoughts and behaviors. These steps are recognized in a variety of behavior modifications, including dieting and treating addiction, as well as in budgeting.

Unsurprisingly, these stages sometimes become cyclical. If individuals backslide to old activities, a step must be repeated to revive the process.

An important part of bringing about change is matching the individual's change efforts to their stage in the process. For example, giving budgeting exercises to someone in the pre-contemplation stage of changing their spending isn't productive. In fact, aggressively trying to force change on someone who isn't ready for (or even interested in) modifying behavior can be counterproductive and delay the person from taking action.

When tackling change and trying to move clients from stage to stage, it's important to understand the clients' intentions. The Theory of Planned Behavior, attributed to Icek Ajzen, asserts that behavior is the result of intentions, and that intentions are affected by attitudes, subjective norms, and perceived control. These elements can affect each other, and the perception of control can directly affect behavior.

For instance, if your clients feel they are entitled to certain spending behaviors, it may be difficult to change their intention to cut back on that spending. That sense of entitlement might come from their family, from their social circle, or from what they see in the media. And their perception about their ability to make that change can also affect their desire to change, potentially enabling them to make the change—or not. As financial professionals, we often advise our clients to consider downsizing a home or cutting back on items like vacations. But our advice is only one part of the equation; our clients must be willing to change their habits. If the clients accept that these are decisions over which they have control—that those decisions aren't dictated to them by their circumstances—they may be more likely to be able to decide to change their behaviors around those issues.

Budgeting strategies in practice

The strategies used by advisors can help clients to work on their intentions. Getting facts and tools in place can help clients see that they have control and take ownership of their spending.

Dan Andrews of Well-Rounded Success has found the personal finance website Mint.com to be helpful in this regard. Rather than just asking clients how they are spending, he draws directly from Mint.com to determine if the clients spent more than they made. From there, Dan and his clients explore the behavioral issues about why they spend impulsively or have other money habits that get in the way of meeting their goals. This exercise ties directly

into the concepts of how perceived control, attitudes, and subjective norms can affect behavior.

Sheila Padden of Padden Financial Planning had a client experience that shows the behavioral change theories in practice. During a qualitative goal-setting meeting, which was intended to explore values and ideals for a couple, the wife cried, saying what she really wanted was to feel comfortable going out to dinner. She needed permission to spend. After that meeting, Sheila helped them understand what they can do with the financial resources available to them. At recent appointment with these clients, the wife mentioned that they were dining out more after the meeting. The client understanding her control over her situation and moving into an action plan liberated her to feel comfortable spending within her means.

Some NAPFA members use Excel spreadsheets to help clients with budgeting. Ryan Mohr of Clarity Capital Management has developed a spreadsheet that he has clients complete with what they think they're spending for fixed as well as variable expenses, plus what they're saving. He then uses financial planning software that aggregates the client's spending accounts to show their actual spending and saving. After comparing the perception and reality around spending, he has them focus on the goals for which they're saving. This allows Ryan to stress the importance of saving—paying yourself first—with his clients. He also has what he calls the 20-30-50 rule. Twenty percent of inflows go into savings. Thirty percent goes toward debt and fixed expenses like mortgage, car payments, and utilities. Fifty percent can be discretionary spending. This metric is also helpful for comparing with the spreadsheet, to see where money is actually being spent.

Kevin Brosious of Wealth Management also uses Excel. He insists that clients give him details—no miscellaneous items are allowed. He feels "the devil is always in the details, and those who are having a problem with budgeting are usually surprised to find out just what they are spending their money on." Often, one of the biggest benefits of working with clients on budgeting is having the clients see what they spend, since many don't really know how much their different needs and wants actually cost by month or over the course of a year. Mastery of the details gives information that makes change easier.

When he works with clients who need permission to spend, Kevin gives them information about how much they can spend without the likelihood of running out of money. This helps retirees who've been good savers, but are reluctant to spend what they've accumulated, understand how they can change their behaviors to enjoy what they've amassed.

The point of budgeting isn't to make people self-conscious about their spending or to criticize where they spend their money. It's to make people comfortable with their ability to fund their goals and have a fulfilling life in the meantime.

Joe Sallee of Bay Capital Advisors says when clients don't understand where their money is being spent, a well-designed Excel spreadsheet can help quantify the opportunity costs of overspending. He finds that when clients track their expenses every month, they can begin to cut down on impulse purchases. Good spending habits are the ultimate goal and an important part of feeling good about their finances.

Another technique used by members is the envelope system. Paychecks are cashed, and the cash is then put into envelopes, one for each category in the budget. Besides being a simple way for adults to manage cash flow, it can be effective in teaching children about budgeting. Details about this system are included in a NAPFA Consumer Education Foundation (NCEF) presentation available to NAPFA members.

These advisors' approaches demonstrate—consciously or unconsciously—matching the budgeting approach with where clients are in the stages of change, as discussed in the transtheoretical model of change. They also address attitudes, norms, and the sense of control that affect the intention to change espoused in the Theory of Planned Behavior. While as financial planners we don't necessarily know the academic concepts that shape our practice, they are often exhibited in effective client work. Awareness of these concepts can help us be more intentional in shaping our strategies to help clients.

Meeting clients where they are

Many of these budgeting tools are effective in the preparation stage of behavior modification. They also take the behavioral change into the action stage. An ongoing relationship with a financial planner can assist clients in the maintenance stage of budgeting.

Since these stages can be cyclical, part of our role as financial planners can be to help people maintain the good habits they adopt. In accord with the Theory of Planned Behavior, we can be cheerleaders and help them find the information that shows they have the control and ability to adopt spending that allows them to live well now and into the future with their resources and cash flow.

Advisors should pay attention to academic research's emphasis on using techniques that match clients' stage of change. For example, perhaps some clients don't need to examine their budget, though they could improve their financial outcomes with modified behaviors.

If clients are saving enough to meet well defined goals and don't have anxiety about where they are spending their money, consider whether it's acceptable to leave budgeting alone. The point of budgeting isn't to make people self-conscious about their spending or to criticize where they spend their money. It's to make people comfortable with their ability to fund their goals and have a fulfilling life in the meantime. If some of our clients can do this without delving into the minutiae of their cash flow, perhaps the details aren't important. For those who do need budgeting help, there are many methods that draw effectively from the theories of how behavior is modified.

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