Why Budgets Fail

And how to create a money management plan that works!

by Pamela Carey Nelson, MBA

If you have ever had your money run out before the month does, then you know what *PayDay Pain* feels like. If so, you are not alone. Between 45 to 60 percent of North Americans currently live from payday-to-payday. The question is, how do you break out of that cycle? When it comes to personal money management the first thing most of us do is create a budget. But budgets have been proven to fail – over and over again. **Here's why:**

1. Errors in Short Term vs. Long Term Estimates.

If you have created a budget, whether for your banker, financial advisor or just on your own, you have probably started with a blank worksheet. Typically you will record all your income and expenses for a one month period. That is the first mistake. Research has shown that budget estimates for a one month period are not as accurate as for a one year period. When estimating expenses for a longer time frame (one year), the budgeter usually adds a room-for-error amount, or a margin for unplanned expenses. Expense amounts are usually estimated to be higher than initially thought of.

When planning for a shorter period (one month) the budgeter also does not usually plan for the unexpected because they are more confident in guessing and do not round-up their estimates. Small expense amounts not included in the budget add up to a significant enough sum to throw off the short-term budget! Most budgets with a one month time frame are *underestimated*. When there is a small, or zero, margin for error and unplanned expenses, the budget doesn't work.

2. Failure to Monitor.

Once a budget has been created it is quickly forgotten. We humans are creatures of habit, and checking in to see how we are doing compared to our budget estimate is something most people just do not do, until it's too late. When the milk has run out and there are still days to go until payday, the stress starts to set in and we wonder "where did the money go!?!" Once the anxiety kicks in we tend to do things that set us further behind financially, like borrow against our next paycheck, use credit to pay for consumables or go into denial. That's not monitoring: that's reacting.

3. Failure to Take Control.

So you are closing in on payday and have $20 left. Can you control yourself to make it last? There are numerous research studies that suggest you probably can't. Most any marketing professional can point to all kinds of research showing why we probably can't hold onto that last $20. One study shows that people will spend money they can't afford to spend simply to restore their sense of power, or to enhance their perception of their social status.

Essentially, budgets fail because they are not typically well thought out and are only one small step needed to start managing your finances. A holistic plan should address your money behaviours, take all weekly, monthly and annual expenses (or spending plans) into consideration, and include a built-in monitoring and measuring component.

How to create a money management plan that works.

Here are four of the six steps outlined in Broke-Free Forever:

1. Know How You Rate

Do you know how your own household spending compares to your neighbors? Probably not: most of us have been raised to never talk about money! That means that we frequently don't really know if what we spend within our own household is at par with average.

A breakdown of the average household expenses and incomes for Canadians and American's is included in Broke-Free Forever. Look up the average for your region and consider where you are in comparison. Are you above or below average income levels for your household type? What about expenses? Where do you sit in comparison to your neighbors for groceries, transportation and shelter?

Example: a closer look at shelter. Many factors will affect the reasonableness of comparing your expenses – such as where you live and the type of housing you live in. The average Canadian spends 19.2% of their income on shelter. Of course, there are two sides to every average (low and high). On the high side, nearly 25% (+/- 3 million) spend more than 30% of their income on shelter. This higher figure is supported by the Survey of Household Spending which suggests the highest percentage of shelter expense belongs to those in the lowest income group; they spend an equivalent 29.8% of their income on shelter. The Annual Spending Survey data reports the lowest income earners spend an average $7,100 on shelter while the Census data suggests an annual cost of $17,500 for mortgage holders and $8,480 for renters.

2. Resist the Urge!

Many impulsive purchases are made due to a lack of self-control; the inability to resist temptation. While the degree of temptation and the degree of available self-control will vary – the first step to resist temptation is awareness. It helps to have some long term goals in mind, and a system to remind yourself of those goals whenever you feel the urge to spend (when you feel the money burning a hole in your pocket my grandma used to call it!)

Hint: Take the self-assessments in Broke-Free Forever to identify your own money management behaviors, self-control and financial personality.

3. Track your numbers.

The best way to overcome short-term estimation errors is to keep track. Track what you spend and you may just be surprised at what you learn! You may be surprised to find out how much cash travels through your pockets, or via your ATM card, for lunches, coffees-to-go and other impulsive purchases. By the way, if you consider ATM an acronym for Always Taking Money – that means you may have a problem! See point #2 above.

4. Calculate your expenses and spending congruent with payday frequency!

Create a long-term budget (like one year); this will give you the greatest likelihood to avoid budget failure. Consider every expense (or reason to spend) that you may encounter over the next year. Then divide those total expenses by the number of paydays that you will have. Now your budget should not only overcome estimation error, you know exactly what you need from each paycheck.

Hint: Use the My PayDay Budget™ spreadsheet application (one of the many support resources included with the Broke-Free Forever online resources) to calculate your own payday budget.

Are you ready to start looking forward to your financial future? Visit BrokeFreeForever.com to start now.

Broke-Free Forever was written to help you **break free** from living payday-to-payday. The book will help you to identify your unique money behaviours, apply basic money principles in a relevant and innovative way, help you to overcome budget estimation errors, inspire you to set realistic personal money goals, and provide you with the tools and resources to create a reasonable and realistic plan to start looking forward to the financial future you want and deserve.

Pamela Carey Nelson, MBA is the author of **Broke-Free Forever. Strategies to Break Free from Living Payday to Payday.** As a single-mom and sole provider for her own household Pamela learned to dig herself out from debt and keep more money from each payday, overcoming her own financial struggles through proactive and cost-cutting strategies. While earning her master's degree in business, Pamela took a special interest in consumer behavior: the behavior related to spending money. Pamela has been helping individuals improve their personal money management habits for years as a business advisor, loans analyst and coach.

In **Broke-Free Forever** Pamela melds her practical approach and real-life experience with principles of business financial management and consumer behavior, culminating in strategies to help anyone who wants to stop being broke, and break the cycle of living payday-to-payday, for good.

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