Budgeting Practices Over the Life Cycle

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The objective of this study was to determine if the presence and formality of spending plans (budgets) varied across the life cycle. Data were collected from a sample of non-metropolitan households in Kansas. Stages of the life cycle were based on a modification of Duvall and Hill's (1948) stages of family development. Results indicated that while most respondents in all stages had some kind of a budget, only a minority had written budgets. Respondents in the retirement age stage were least likely to have any kind of budget, and least likely to have a written budget. However, they were most likely to have a budget that covered a period longer than one month. Implications for financial advising and education are discussed.
KEYWORDS: *budgets, life cycle*

Recently both academic textbooks and the popular financial press have emphasized a life cycle approach to family financial management (see, for example, Block, Prevy and Thorton, 1988; Bodnar, 1990; Garman, and Forgue, 1991; Gitman & Joehnk, 1990). Households at different stages in the life cycle are typically expected to have different needs. Households in the early stages of the life cycle may be primarily concerned with building up a stock of durable goods, building an adequate insurance portfolio, and providing for the consumption needs of a family which may be growing. Households in the later stages of the life cycle are more likely than households in the earlier stages to be concerned with building wealth to supplement retirement income. The financial resources available to the household change over the life cycle as well. Data on average income from the 1983 Consumer Expenditure Survey (Federal Reserve Bank of Minneapolis, 1986) show the pattern plotted in Figure 1, where income increases with age until the householder reaches about age 55, then drops sharply around the traditional retirement age of 65 before leveling out. Expenditures show a similar curvilinear pattern, but the peak spending years fall between the ages of 35

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Figure 1.
Income and spending over the life cycle

and 45. For the average household, income expenditures exceed income until the mid-thirties, at which point income begins to exceed spending and continues to do so until the end of the life cycle. Between the ages of 45 and 65, income is considerably greater than spending. This offers to the household, perhaps for the first time, the opportunity to save and invest.

Given such changes in financial resources and demands, and the ratio between them, it seems reasonable to expect that financial management practices would also change as individuals move through the life course.

There is evidence, reviewed below, that this is indeed the case. The purpose of this study was to determine if one financial management practice, budgeting, varies over the life cycle. Specifically, the objectives of this study were to determine

a) whether the incidence of reported budgeting varied across the life cycle, and
b) whether the kind of budget used (mental or written) and the time horizon covered by the budget varied across the life cycle.

Review of Related Literature

Research on family financial management has a long history, going back to the early 1930s (Woodhouse, 1931). Godwin (1990) has noted that many of the earlier studies relied on small, non- random samples and descriptive statistics. In the 1980s, there was renewed interest in family financial management practices, including budgeting. Mullis and Schnittgrund (1982) found that 53% of their sample of low-income urban families used a budget. They hypothesized that families in the expanding stage of the family life cycle would be more likely to report that they budget, and more likely to have a formal, written budget than those in the beginning or contracting stages. However, their findings supported neither hypothesis. In subsequent re-examination of the same data, Schnittgrund and Baker (1983) found that about two-thirds of the households in the sample reported having a budget, but the plurality said they had a "general idea" for allocating their funds, rather than a written plan. Godwin and Carroll (1986) developed an inventory of 18 recommended financial management practices, including three items related to current budgeting practices. Responses to the items varied by the gender of the respondent. For example, 36% of the wives but only 25% of the husbands reported having a "written plan that shows how you plan to use income." Age was significantly and negatively related to the inventory for husbands but not for wives; that is, the younger husbands in the study reported using more of the practices than did the older husbands. Beutler and Mason (1987) hypothesized that both age and stage in the family life cycle would affect a variable which they called "budget formality." They defined formal budgeting as "written plans made in advance for a period of up to a year, with written records of expenditures followed by regular review and evaluation." They found that only 10% of the households in their sample met their criteria for a formal budget. They also found a substantial negative relationship between age and budget formality, and a significant, but weaker, negative relationship between stage of the life-cycle and budget formality. Titus, Farnslow and Hira (1989) reported that 70% of their respondents estimated household income and expenses but only 19% had written financial plans. These two practices were part of an inventory of financial planning behaviors, and the inventory as a whole was negatively related to age. Scannell (1990) found that 77% of her sample of dairy farmers said they had a spending plan. The relationship between age and presence of a spending plan was not investigated in that study.

Methods

The data used in this study were collected as part of a larger study (Money Management Practices of Kansas Households) designed to investigate the impact of financial management practices on selected objective and subjective measures of financial well- being. At the request of the funding agency (the Kansas Agricultural Experiment Station) the target population was restricted to households outside the Standard Metropolitan Statistical Areas (SMSAs) of the state. A two-stage cluster sample was employed. In the first stage, a sample of counties which did not include a SMSA within their borders was drawn; in the second stage, a sample of residential telephone listings from within the sampled counties was drawn. The use of telephone directories as the sampling frame probably excluded some households in the target population, such as those with very low incomes, those with unlisted numbers, or those who have recently moved. However, there is evidence that telephone directories provide a more complete listing of households in non-metropolitan areas than in metropolitan areas (Dillman, 1978, p. 240). Data were collected by means of a mail questionnaire in the spring of 1984, following procedures recommended by Dillman (1978). From 1200 initial contacts, a total of 672 usable questionnaires were returned. When ineligible households were excluded from the list of initial contacts, the response rate was 61%.

Demographic characteristics of the sample are given in Table 1. The typical respondent was a married individual, about 48 years old, who had received some training or education past the high school level (this includes training at a technical school as well as college courses). Household income, measured in 11 categories, ranged from under $5,000 to over $100,000; the midpoint of the median category was $22,500.

Table 1
Demographic characteristics of the sample

Mean age of respondents	48.85 years
Mean education level	2 years post-secondary
Median income level	$22,500
Mean household size	2.7 persons

As defined in this study, a budget is a plan for spending and saving money. Respondents were asked if they made such a plan, and if they answered yes, they were asked to describe the plan on a five-point scale ranging from "completely mental" to "completely written." Respondents were also asked to identify the time period their plan covered, with five possible responses ranging from "one week" to "one year" in length. Answers to these three questions became the three dependent variables in this study.

Previous studies on the relationship between financial management practices and stage of the family life cycle have used operational definitions of "stage of the family life cycle" that depended in part on the presence and age of children. (See, for example, Mullis and Schnittgrund [1982] and Beutler and Mason [1987].) There are several different variations of the life cycle, developed by researchers in psychology, family sciences, and marketing, among other disciplines. Perhaps the most widely used life cycle in the family sciences is the eight-stage classification by Duvall and Hill (1948). The analyses were originally attempted with a variation of this model as the independent variable; however, small cell sizes rendered an eight-stage independent model impractical. Therefore, the original eight stages were combined into four stages, similar to the beginning/expanding/ contracting classification used by Mullis and Schnittgrund, with an additional category for retirement-aged respondents. The final four categories, and the criteria by which respondents were assigned to them were:

1. BEGINNING STAGE: people aged 40 or younger, married or single, without children;

2. EXPANDING STAGE: married couples whose oldest child was under 13 years old;

3. CONTRACTING STATE: married couples whose oldest child was 13 years old or older, including married couples under age 65 without children in the home; and,

4. RETIREMENT-AGED STAGE: married couples and widowed persons age 65 and older.

Given the incidence of divorce, remarriage, and long-term singlehood in the United States at present, any scheme of life cycle stages must either allow for several tracks (such as the one developed by Stampfl [1979]), or else exclude some minorities of the population. The classification used in this study resulted in the exclusion of singles over the age of 40 (never married and divorced), widowed persons under the age of 65 without children, and single parents. The small number of cases in each of these groups precluded separate analyses of their budgeting practices.

Grouping single persons with married couples, as was done in the first and last stages of this life course model, is unusual, but there is reason to argue that two groups in these categories are more like each other than like persons in the other stages or persons in the excluded categories. The younger singles may yet anticipate changing to the lifestyle the younger married have already assumed; both groups have no responsibility for children, and both groups might expect to be in the paid labor force for another 25 to 30 years. The singles and married couples in stage four are alike in that they have little, if any, time remaining in paid employment, and thus must shortly face the challenges of supporting themselves on whatever retirement capital they have accumulated over time. While it is true that married people have financial responsibilities to their spouses that singles do not, it should also be noted that in this sample, 81% of the younger married couples without children were dual-earner couples. Therefore, in most such households the spouse was not completely dependent on the respondent for financial support, as most minor children are upon their parents.

The Chi-Square was chosen as the statistic to test for possible relationships between stage of the life cycle and

a) the presence of a plan (budget);
b) the kind of plan (mental or written) used; and,
c) the time period covered by the plan.

In the case of the second dependent variable (kind of plan), the categories "completely mental" and "mainly mental" and the categories "mainly written" and "completely written" were combined to alleviate the problem of small cell frequencies. For the same reason, the responses on the third dependent variable (time period covered by the plan) were combined into two categories: "one month or less" and "several months to one year."

Results

Tables 2 and 3 show the distribution of respondents across the variables of interest. Over eight in 10 respondents reported they had a plan for disposing of their money, but only 7% indicated that this plan was "mainly or completely written." Most of those who had budgets were short run planners; only 33% reported that their budget covered a period of several months to one year. The respondents were concentrated in the later stages of the family life cycle, with the plurality (39%), in the "contracting" category.

While the majority of respondents in all four stages reported they had a budget, the proportion of respondents who did *not* plan was lowest among expanding families and highest among retirement age households; over one in four of the latter group did not have a plan (see Table 4).

Plans that were mainly or completely written were reported by a minority of all households, but were more prevalent among the households in the first two stages (see Table 5). However, the small number of cases in these cells makes the results somewhat suspect. Also of interest is the curvilinear pattern shown in the "mainly or completely mental" category. It appears that after some point in middle adulthood, or after children arrive, households shift away from largely mental budgets and towards plans that are partly written.

Table 2.
Distribution of respondents across budgeting practices

Budget practice	%	(n)

1. Do you generally make some kind of plan before spending your money?

YES	82%	(545)
NO	18%	(119)

2. Is this spending plan mental or written, or both?

NO PLAN	18%	(119)
COMPLETELY MENTAL	8%	(55)
MAINLY MENTAL	24%	(137)
MENTAL & WRITTEN	44%	(232)
MAINLY WRITTEN	5%	(36)
COMPLETELY WRITTEN	2%	(11)

3. How long a time period does this plan cover?

NO PLAN	18%	(119)
A WEEK	7%	(43)
TWO WEEKS	9%	(56)
A MONTH	28%	(184)
SEVERAL MONTHS	20%	(127)
A YEAR	13%	(84)

Note: Percentages may not sum to 100 due to rounding

Table 3.
Distribution of respondents across life cycle stages

Stage	%	(n)

1. BEGINNING, respondent under 40, married or single, without children	9	50
2. EXPANDING, married couple with children under 13 years old	29	161
3. CONTRACTING, married couple, oldest child 13 years old or older, respondent aged 64 or younger	39	216
4. RETIREMENT AGE, married couples or widowed persons 65 years old or older	24	131

Table 4
Presence of budget by stage of the life cycle

	Stage of life cycle			
	Beginning	Expanding	Contracting	Retirement
Budget Present	%(n)	%(n)	%(n)	%(n)
Yes	88(44)	91(145)	82(177)	73(92)
No		22 (4)	9 (15)	18 (38)
	27(34)			

X^2 (3, N = 551) = 16.54, $p < .001$

Table 5.
Kind of plan by stage of the life cycle

Level of formality	*Stage of family life cycle* Begin	Expand	Contract	Retire
	%(n)	%(n)	%(n)	%(n)
Mainly or completely mental	47(21)	31(44)	38(67)	45(41)
Both written and mental	42(18)	56(81)	55(95)	53(48)
Mainly or completely written	2 (2)	11 (5)	13(19)	7(13)

X^2 (6, N = 454) = 14.47, p. < .05

Table 6.
Time horizon of plan by stage of family life cycle

Time horizon of plan	*Stage of the family life cycle* Begin	Expand	Contract	Retire
	%(n)	%(n)	%(n)	%(n)
one month or less	76(31)	68(54)	55(87)	35(29)
several months to one year	24(10)	32(44)	45(70)	65(55)

X^2 (3, N = 420) = 30.28, p. < .001

The cross-tabulation of the time horizon of the plans by stage of the family life cycle (Table 6) shows that as people move through the life course, they increasingly move from very short term planning to planning over a longer term. Less than one-fourth of those in the expanding stage of the life cycle had budgets that covered a time period of several months to one year, compared to over two-thirds of those in the retirement-aged stage.

Discussion

The findings of this study are consistent with two findings of previous studies: (1) most households report that they have some method of budgeting their money, and (2) these budgets are informal in the sense that only part, if any, of the budget is written. The findings suggest that households are more likely to have a budget, particularly a written budget, in the earlier years of their lives, especially in the expanding stage of the life cycle. Such findings are consistent with some of the previous studies (e.g. Godwin and Carroll [1986]; Beutler and Mason [1987]; and Titus, Farnslow and Hira [1989]). The findings are inconsistent with those of Mullis and Schnittgrund, who found that neither the proportion of respondents who had budgets or the formality of the budget varied across their stages of the family life course. The differences in findings may result in part from differences in the samples: in the Mullis-Schnittgrund study, the respondents were all lower income households, probably with little discretionary income no matter what their stage of the family life cycle. The respondents in this study were a more affluent group, and thus more likely to have some income available after paying for necessities. Also, the assignment of households to life cycle stages differed somewhat between the two studies. Households with pre-school children were assigned to the beginning stage of the life cycle in the Mullis-Schnittgrund study, and to the expanding stage in this study.

It appears from the results of this study that the budget practices of retirement age households differ substantially from the practices of younger households. Respondents in this group were least likely to report having a budget, especially a written one, but most likely to report that their plan covered the course of several months. Financial advisors working with this age group need to recognize that the management practices of these clients have evolved over a number of years. It may be a mistake to assume that retirement-aged clients who do not have formal written spending plans need such plans. It is possible, for example, that many households in the retirement stage have developed very stable, predictable patterns of income and spending, and thus perceive no need for a budget.

There is also evidence (Prochaska-Cue, 1991; Rettig and Schultz, 1991) that individuals differ in their personal financial management styles. Most of the normative literature on personal finance reflects a preference for a highly structured, sequential approach to processing information. However, not all people process information in this manner. Prochaska-Cue (1991) questions whether there can be one "right" way for people to manage their money. Rather, she suggests that there may be several effective means, reflecting different management styles. If one accepts this line of reasoning, it follows that advisors need to determine what methods of financial management their clients are currently using, and how effective these methods are in terms of meeting the clients' stated financial objectives, before recommending changes in current procedures.

For both retirement-aged households and their younger counterparts, the preparation of a detailed written budget requires time: time to gather and analyze information about income and expenditures in the past, time to solidify vague aspirations into concrete goals with price tags, and time to meld information about the past with expectations about the future into a workable budget. The degree to which people are willing to devote this kind of time to budget preparation may depend in part on what they want the budget to accomplish. If a household's objective in making a budget is simply to be sure that all the bills get paid each month, then perhaps a mental budget on a month by month basis will suffice. If, in contrast, the household is seeking to build savings towards some goal without substantially lowering consumption levels, a more formal and detailed plan may be required. Financial advisors and educators may need to identify what their clients want a budget to accomplish, before they can assist in developing a budget that meets those objectives.

The process of making a formal budget is well understood. It is the incentives that actually lead people to embrace (or reject) the process that remain unclear. Perhaps there are critical transitional points (e.g. first entry into the work force, the birth of a child, the dissolution of marriage) following which a household is more likely to perceive the need for a more detailed and formal budget. Stated another way, perhaps detailed, formal budgets are reactions to major financial changes. These formal budgets, while not abandoned completely after the household has adjusted to the change, are allowed to evolve into short-term, informal plans. Further research is needed to determine if it is stages of the life cycle, or rather certain key events that occur throughout the life cycle, that best predict budget practices.

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