InvesTips

How to create a budget and stick with it

December 2023

WS Global CIO Office

What is budgeting?

> "Do not save what is left after spending; instead spend what is left after saving."
>
> **– Warren Buffett**

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Budgeting is an important building block of personal finance. The word 'budget' can feel restrictive, and the variety of budgeting methods can add to the confusion. However, a budget is essentially a system that allows you to plan for your income and expenses over the course of a set period.

Why do you need a budget?

Creating a long-term financial plan is usually like mapping a series of many short/medium term plans with different goals over different periods of time. Budgeting is an effective tool to put you in the driver's seat of your finances for this financial journey.

- **Create more (financial) freedom, not less:** Budgeting is essentially a critical first step for any financial plan as it provides you with clarity of your financial situation – specifically, what is available for spending and saving. Consequently, budgeting empowers you to master your spending and saving habits, leading the way to more financial independence.
- **Control impulse (financial) habit:** If overspending is your Achilles' heel, budgeting can act as a vigilant guardian. It helps spot and curb harmful spending habits while trimming unnecessary expenses.
- **Reduce financial stress:** A well-planned budget is your stress buster. It is an effective tool to plan and build emergency savings, thereby creating a cushion if unforeseen events occur.

5 steps to create a budget

1 Determine your income

The first step would be to determine the average monthly net income – as in, your take-home pay. This includes the salary, wages from freelance work or side gigs, bonuses and any other sources of income, but be sure to deduct any estimated taxes owed or other deductions.

2 Track expenses

The next step would be to have a list of all expenses for a certain period, such as a month or a week and categorize them into fixed and variable expenses.

Fixed expenses include regular and consistent ones, such as rent/mortgage, household expenses, payments towards insurance premiums or loans and subscriptions. Any contributions to a savings account will also need to be treated as a fixed expense.

Variable expenses cover all discretionary expenses, such as groceries, transportation, dining out, entertainment and personal care products. These often fluctuate from month to month. Include even money spent on one-offs such as vacations, but as they would be an annual expense, divide them by 12 so that they can be included in the budget.

3 Determine the average monthly cost for each expense

Next, group the expenses into categories such as housing, utilities, transportation, food, healthcare, debt payments, entertainment, savings, and investments. The categories can be customised based on the specific needs and priorities. Then, allocate a specific amount of money to each category. Start with the fixed expenses as they should ideally have set amounts. For variable expenses, estimate the average amount typically spent per month in each category.

4 Allocate the income

Assign specific amounts of the income to each expense category based on the priorities and financial goals. Start with essential expenses like housing, utilities and debt payments. Then allocate funds to other categories, such as transportation, groceries, entertainment, savings and investments. Set specific and realistic spending limits for each category.

If the expenses exceed your income, this might be the right time to revisit the budget to find areas to reduce spending or identify ways in which you might increase your income.

5 Monitor and adjust

Regularly monitor your spending, compare with the allocated budget, and adjust as needed. If you are consistently overspending, it is time to re-evaluate your lifestyle. Start by examining your expenses to pinpoint where you can cut back, especially in variable costs. However, do not overlook fixed expenses. Sometimes, bigger changes, like relocating to a more affordable area, can significantly ease the challenge of sticking to your budget.

What are the common methods of budgeting?

"The secret to budgeting is that it needs to be honest. Not what you think it should be or wish it could be, but what it really is."

– Lisa Conway-Hughes

Zero-based budgeting

Zero-based budgeting involves budgeting your income down to the last dollar. The goal is to give every dollar a job so there's no money wasted or left over. This involves allocating every dollar of income towards specific categories or expenses.

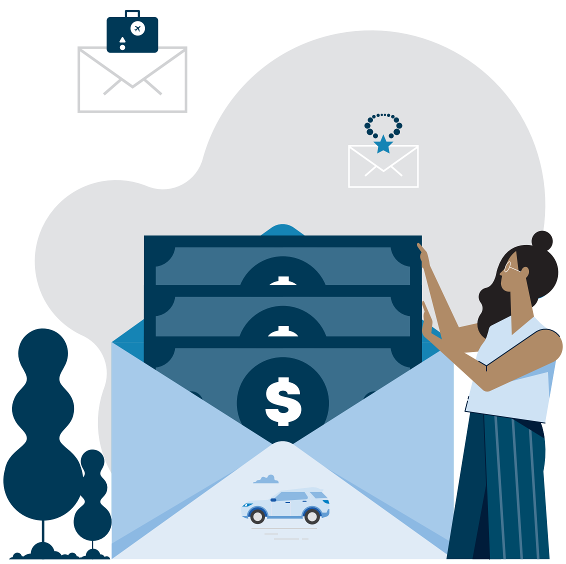
- Start with the total income and then assign amounts to expenses, savings and investments until it reaches zero.
- It would require tracking and categorising all expenses and income meticulously.

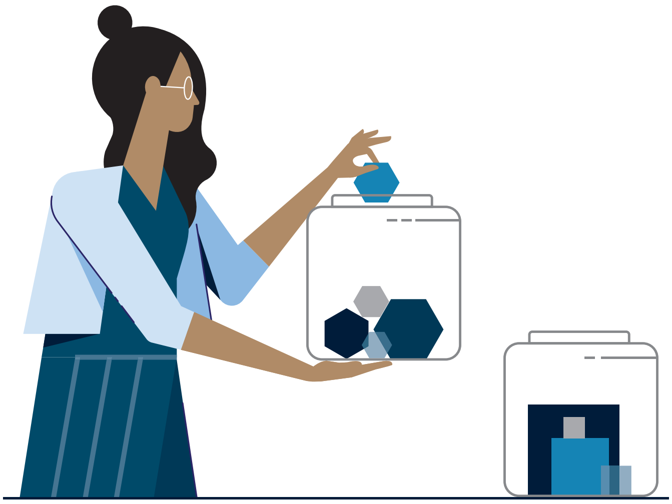
This budgeting method considers every dollar you earn and has a plan for it. If you've wondered where your money is going, this could be a type of budgeting to try out.

Cash envelope budgeting

This is a physical method of budgeting that involves using envelopes to allocate cash for different categories of expenses. Each envelope represents a specific spending category (such as groceries, entertainment, or transportation). This method requires adding the allocated cash into each envelope at the beginning of the month and only spending what is available in each envelope. If the cash is gone, the budgeting limit has been hit and no more should be spent in that category. Budgeting this way can be used to combat overspending and help pay off debt.

However, in today's largely cashless society, using the cash envelop method can face some challenges as many merchants might not accept cash as the preferred mode of payments. As such, we believe adapting the cash envelope budgeting method to digital platforms can be a more helpful solution. Instead of using physical cash and envelopes, you can replicate this system with debit cards. Allocate a specific amount to each card, corresponding to different budget categories. When a card's balance runs low or depletes, that's your cue to stop spending in that category. Using multiple cards for various spending areas can help you maintain control over your finances, mirroring the traditional envelope method in a modern, cash-free format.





50/30/20 method

The 50/30/20 budget rule simplifies managing your finances by allocating specific portions of your income to needs, wants, and savings or debt repayment. Here's how it works: 50% of your income goes towards essential needs like housing, food, and transportation. Then, 30% is dedicated to wants, such as subscriptions, entertainment, and travel. The remaining 20% is for savings and paying off debts, like building an emergency fund or contributing to retirement savings.

Ideal for beginners or those restarting their financial journey, this method offers a straightforward framework for balancing spending and saving. It's particularly helpful for young adults setting their first budget or individuals adjusting to single-income living. While this budgeting style provides a solid starting point, it may not suit everyone. For instance, those in high-cost living areas or with heavy debt might find the 50% allocation for necessities restrictive. In such cases, adjustments to the formula are necessary to better fit individual financial situations.

Budgeting by paycheck

This method involves budgeting for each paycheck, making it ideal for those with fluctuating incomes. The goal is to manage your finances within the period of each paycheck. You start by determining your income for that period, identifying your expenses, and setting aside a portion for savings. Since income and expenses can vary, this approach allows for monthly adjustments, ensuring that your budget remains flexible and responsive to your changing financial situation.

Pay yourself first

"Paying yourself first" means prioritising savings and investments by immediately setting aside a fixed amount or percentage of your income each month. The rest of your income is then used for other expenses. This approach is especially useful if you find it hard to save money after covering all your expenses. By putting savings first, it becomes a habit rather than an afterthought, ensuring that you consistently build your financial future before meeting other financial obligations.

How to stick with a budget?

"Beware of little expenses; a small leak will sink a great ship."

– Benjamin Franklin

Creating a budget is just the first step; the real challenge is sticking to it.
Here are some effective tips to help you stay on track:

Track expenses regularly

Keep a close eye on all your spending, even the small purchases. This practice sheds light on your financial habits, revealing unnoticed spending patterns and highlighting areas where you can save. Understanding your spending behaviors helps you set realistic boundaries and avoid overspending.

Weekly budget check-ins to ensure you're on track for your budget goals

For those that are new to budgeting and struggle to stay disciplined with the budget, it is encouraged to have a weekly check-in to assess how your actual spending compares to your planned spending and then pivot when necessary.

Review your budget regularly

A successful budget is rarely a set-it-and-forget-it venture. It changes with you. Regular reviews are essential to ensure it aligns with changing incomes, expenses, and financial goals. Whether it's a salary increase, a rise in rent, or a new saving target, these changes necessitate adjustments to your budget. Keeping it updated ensures it reflects your current priorities and needs.

Utilise automated budgeting apps

For those new to budgeting or finding the process overwhelming, budgeting apps can be a game-changer. They automatically track your income and expenses by syncing with your financial accounts. These apps offer visual spending breakdowns, goal-setting features, and alerts to keep you on course, simplifying the budgeting process and making it more manageable. By incorporating these strategies, you can make budgeting a less daunting and more effective tool for managing your finances.

Conclusion

Budgeting, often seen as challenging task, is a cornerstone of successful long-term financial planning. Especially for those that just start out or are currently facing financial strains, the discipline of budgeting can seem daunting. Yet, its benefits are undeniable. A well-structured budget can act as a roadmap, guiding you through financial uncertainties and helping to ensure stability.

Effective budgeting is not just about cutting cost, it is about making smart choices that align with your financial goals. By consistently monitoring and adjusting your budget, you can develop a deeper understanding of your financial habits which is crucial for long term planning. This is because this discipline not only prepare you for unexpected cost but also enables you to save and invest toward your future ambitions, like buying a home or securing a comfortable retirement life and finally achieving financial freedom and security over time.

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