

# FOUR TRENDS MAKING BUDGETING MORE IMPORTANT THAN EVER



## Budgeting Is Key to Financial Wellness

Financial wellness is realized by adopting behaviors that help achieve the foundational elements of financial security: managing day-to-day finances, achieving important financial goals, and protecting against major financial risks.<sup>1</sup> Of the three elements, managing day-to-day finances is key, because it underpins the other two elements — by managing day-to-day finances, individuals are more likely to be able to have the resources to achieve important financial goals and protect against financial risks.

Managing day-to-day finances involves budgeting and reducing debt levels. Budgeting is especially important for younger adults, because it can help them establish a mindset and discipline that can last a lifetime. In addition, budgeting can help younger adults to start saving early, which makes a significant impact on outcomes. Conversely, the absence of good budgeting in the early working years may lead to financial shortfalls that can derail individuals' ability to save adequately for retirement and protect themselves against unexpected life events.

Only about one-third (32%) of American households keep a detailed budget<sup>2</sup>; however, the state of personal finances today indicates that most individuals need help with budgeting. Over 60% of Americans don't have a "rainy day fund" with enough savings to cover a \$500 emergency<sup>3</sup> — roughly equivalent to the cost to replace a broken washing machine. Prudential's research indicates that one-quarter (25%) of employees spend their full paycheck — or even more — each month.<sup>4</sup> More than half of surveyed pre-retirees recognize that saving for retirement is getting progressively harder for each generation, and expect to have a more difficult time than their parents or grandparents did.<sup>5</sup>

This paper explores trends that are making budgeting increasingly important: a proliferation of social media, an increasingly cashless society, a shift in employment, and outsized expenses. Together, these trends result in increased spending, more volatile income, additional financial responsibilities for individuals, rapidly increasing expenses, and lower returns on investments. As long-standing providers of employee benefits, employers are well positioned to help employees overcome these budgeting challenges and achieve financial wellness.

**"We must consult  
our means rather  
than our wishes."**

– George Washington

**"Beware of  
little expenses:  
a small leak can  
sink a great ship."**

– Benjamin Franklin

## Current Trends That Make Budgeting Increasingly Important



## Four Trends Are Increasing the Importance of Budgeting

Four trends challenge individuals to stretch a given level of income to cover increasing demands, making budgeting increasingly important today.

**1 Social media is increasing consumer spending** due to customized marketing campaigns as well as the subtle influence of peers' social posts.

According to Gallup, 30% of surveyed consumers say social media has some influence on their purchasing decisions, and another 5% say it has a great deal of influence. For Millennials, these percentages are 43% and 7%, respectively — indicating that half of Millennials are influenced by social media on purchases.<sup>6</sup>

A Deloitte consumer survey indicates that 47% of all Millennial consumers use social media during their shopping journey, compared to 19% of non-Millennials. Those who use social media during their shopping process are about four times more likely than non-users to spend more than they originally planned on purchases.<sup>7</sup> One explanation may be that data-driven digital marketing techniques enable advertisers to target ads to individuals with more precision, increasing the likelihood of success. Partially offsetting this incremental spend is that social media may help individuals save money by finding the best price on items.<sup>8</sup> For example, “liking” a store or brand will keep individuals notified of coupons and deals.<sup>9</sup>

Social media also influences spending in subtle ways through peer pressure. Friends often happily share photos of their new house, luxury vacation, new hobby, or meal from a new restaurant. Individuals may see an onslaught of posts showing the good fortunes of friends — even those “friends” they barely know or have not seen in years. Individuals may feel tempted to keep up with others, even if they can't afford it.<sup>10</sup> A study found that individuals who spent relatively long periods of time on social media and had strong online

social networks were likely to have lower credit scores and more credit card debt than those who used social media less frequently and had weaker networks.<sup>11</sup>

**2 An increasingly cashless society increases consumer spending**

by creating a psychological disconnect between purchases and the physical drawdown of money.

When using cash to pay for items, individuals experience a physical cost. They also have a tangible way to track how much they have spent — that is, how much is left in their wallet, which directly impacts the amount available to spend on the next cash transaction. With credit cards, individuals do not have to think about the direct impact that a purchase has on the cash available for the next purchase, or think about payment until the next month — making it a challenge to monitor actual versus budgeted spending levels.

Academic research supports this notion, indicating that individuals are willing to spend more when they use a credit card than when using cash, and suggesting the underlying reason is partly due to the way cash can reinforce the pain of paying.<sup>12</sup> An MIT study, published in 2001, indicates that, in certain contexts, people were even willing to pay up to twice as much for the same item when paying with a credit card instead of cash.<sup>13</sup> The authors of the study also cite research indicating that: individuals who own more credit cards make larger purchases per department store visit, restaurant tips are larger when payment is by card, and credit card users are more likely to underestimate or forget the amount spent on recent purchases.

Credit cards enable individuals to spend more for non-discretionary items, too. In 2016, twenty-six percent of employees used credit cards for monthly necessities they could not afford otherwise, up from 22% in 2013.<sup>14</sup> Surprisingly, this did not vary significantly across income levels (31% for employees earning under \$30,000 vs. 22% for those earning over \$100,000) or generation (30% for Millennials vs. 27% for Gen Xers, and 21% for Boomers).<sup>15</sup>

Social media influences may lead to increased spending; setting a budget may help to keep those influences in check.

The growing trend in mobile payments may further disconnect a purchase from a physical drawdown of money. Forrester forecasts that overall mobile payments will grow at a 20.3% compound annual growth rate from 2016 to 2021.<sup>16</sup>

- The proliferation of new payment methods, such as Venmo and Apple Pay, may increase the number of payment methods that an individual uses, making it even more difficult to track the total amount spent. Mobile payments further steer individuals from using cash; for example, now individuals can use Venmo to reimburse their friends for their portion of a shared restaurant bill.
- Mobile technology provides the opportunity for marketers to provide a valued customer experience. Starbucks links its mobile payment app with a store locator, reward program, and any specials. Consumers can even order drinks for pickup.<sup>17</sup> This integrated approach and seamless customer experience facilitates purchases.

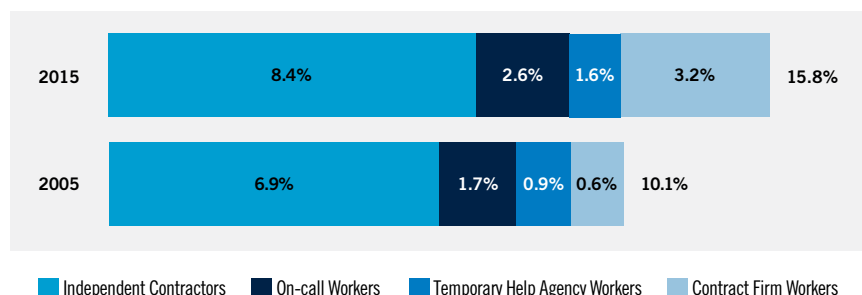
**Individuals should avoid “spending creep” with noncash payments by closely monitoring their spending vis-à-vis their budgeted spending allocations.**

**3** **Income is becoming more volatile, as employment is shifting** from traditional full-time employment to alternative work arrangements and frequent job switching, creating budgeting challenges of self-funding benefits and retirement savings and living with irregular income.

Alternative work arrangements include temporary and part-time work, as well as contractual arrangements, such as independent contractors. While there are many definitions of the alternative workforce and estimates of its size, one estimate reports these arrangements comprised 16% of the workforce in 2015, up from 10% in 2005.<sup>18</sup>

Google’s parent, Alphabet, is a notable example of the contractor model. Sources estimate that Alphabet has about as many outsourced workers as full-time employees.<sup>19</sup> Contractors, vendors, and temps perform a range of important functions — from testing self-driving cars to managing marketing and data projects.<sup>20</sup>

#### Alternative Work Arrangements (percentage of all workers)



Source: Lawrence Katz and Alan Krueger, “The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015,” 2016.

While the contractor model may provide more flexibility for many employers and workers, it has a downside for the workers’ pay, benefits, and job security. Individuals with alternative work arrangements may have irregular incomes which make it difficult to save systematically and manage a budget. They may not have access to employer-sponsored retirement benefits and employer matching contributions, as well as benefits that help protect against key financial risks, such as premature death, disability, and critical illnesses. In addition, alternative workers may not be eligible for paid vacation or health insurance.

This reduced access to benefits and retirement plans reinforces a trend well underway in which financial responsibilities and risks shift from employers to employees, leaving employees burdened with funding a greater portion of healthcare and retirement costs. This shift, compounded by the fact that longevity is increasing, is driving retirement costs up at a time when it is especially difficult to grow a retirement nest egg due to the impact of historically low interest rates on investment returns.

Even employees who have traditional employment arrangements are now changing jobs more frequently, and may be subject to employment actions, such as downsizing. In a survey of retirees, about half (51%) retired earlier than planned. Thirty percent of those who retired earlier than planned were laid off from their jobs or offered an early retirement incentive package. Of the retirees who retired earlier, half (50%) retired five or more years earlier than expected.<sup>21</sup> For many, this significant loss of income means fewer years to accumulate savings, and more years of retirement to fund.

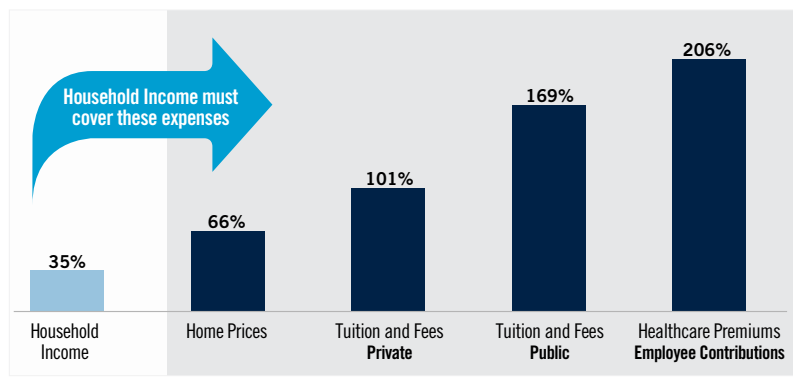
Frequent job switching increases the likelihood that employees may leave money on the table when leaving an employer — some employees leave at the wrong time of year and miss out on year-end employer contributions. Others may leave before they are fully vested in a plan and lose part or all their employer contributions.<sup>22</sup> The median amount of time Americans spend at one job was 4.2 years in 2016, down from 4.6 years in 2014.<sup>23</sup>

**Given new employment models, individuals may need to adjust their budgets to account for having to self-fund their benefits and retirement savings, and living with less stability of income, job security, and control over retirement age.**

**4 Outsized big-ticket items are growing faster than income,** including home purchase prices and college costs, leading many individuals to assume more debt and reducing their discretionary income.

As shown in the bar chart, major expense categories have increased faster than wages from 2000 to 2015, creating more demands on each dollar of income.

## Growth in Household Income and Major Expenses 2000 – 2015



Sources: Federal Reserve Bank of St. Louis, College Board, Kaiser Family Foundation.

A home is likely one of the biggest purchases an individual makes. From 2000 to 2015, the national median home price increased 66%,<sup>24</sup> versus a 35% increase in median household income.<sup>25</sup>

Levels of student debt are ballooning, placing a higher burden on individuals, especially Millennials, than ever before. College costs have risen faster than household income. From 2000 to 2015, tuition and fees increased 101% for private colleges and 169% for public colleges.<sup>26</sup>

As a result, the use of student loans to pay for college has grown substantially. Seventy-one percent of the class of 2015 graduated with student loan debt, as compared to 54% of graduates 20 years earlier. Meanwhile, the average amount borrowed more than tripled over the same period, from an average debt amount of \$11,491 in 1995 to \$35,051 in 2015.<sup>27</sup>

**Individuals may have to allocate a larger portion of their income to cover fast-growing costs of housing and tuition, often in the form of debt.**

## Employers Can Help Employees Cope with Today's Budgeting Challenges

The trends explored in this paper are increasing the importance of budgeting, which is a key component of managing day-to-day finances — the first step toward improving financial wellness. As a result, employees need more help than ever in achieving financial wellness.

Although the employment model is shifting, employers remain long-standing providers of employee benefits, and are generally viewed by employees as trusted partners who can help them achieve financial wellness. Employers should consider providing financial wellness education and programs that help employees manage day-to-day finances, achieve key financial goals, and prepare for the unexpected. Improving employees' financial wellness helps to reduce their stress and distractions and, thereby, also benefits employers by contributing to increased workplace productivity and workforce cost management.

To help employees proactively make informed decisions to manage their day-to-day finances, employers may consider offering:

- Onsite or digital financial wellness education and counseling, to help employees adopt good financial behaviors that become part of their lifestyles.
- Budgeting tools, in which employees create a personalized budget that is relevant to them and tracks their progress. Technology can play an important role in budgeting tools by aggregating the information necessary to provide a holistic view of an employee's financial life. As a starting point, employers already have foundational data at their fingertips, such as compensation levels, savings and insurance plans, and health savings accounts. Budgeting tools may allow employees to automatically import their external data from bank and other

financial accounts and combine it with data supplied by their employers, so that they can view their account balances and transaction history in one place. This account aggregation makes it easier to identify areas of improvement and facilitate decision making that drives meaningful changes in financial behavior.

- Financial wellness self-assessment tools, so that employees have a clear picture of their financial strengths and gaps. In addition, employers may leverage the insights and data that these tools generate to understand the financial needs of their employee base, and customize a suite of benefits and education to best meet their needs.
- Financial solutions that encourage employees to save systematically. These include student loan debt repayment programs to help employees pay down their debt, and defined contribution (DC) plans with automatic enrollment, automatic escalation of employees' contribution levels over time, and employer matching contributions. One way to help partially offset the increased need to save is through guaranteed lifetime income products, which help to reduce the level of DC plan savings that employees need to generate their desired level of retirement income. Prudential's research estimates that incorporating guaranteed lifetime income products into a DC plan reduces the level of assets required for a typical participant to retire at age 65 by 36%.<sup>28</sup>

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