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Mental budgeting: How young people manage their money, credit and debt

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Abstract
Students' spending and levels of debt have already been researched both within the marketing arena (e.g. Prince [1]; Palmer, Pinto and Parente [2]) and other disciplines - in particular, economic psychology (see, for example, Scott, Lewis and Lea [3]; Webley et al. [4]). This current research extends previous studies to include a broader sample of young people in the UK aged between 17 and 21 years, exploring how they spend their money and how they manage their finances. Findings from depth interviews and focus groups suggest that for all these participants there is recognition of the importance of structured financial planning and money management, but that in reality any such planning is via mental budgeting which may lead to over- and under-consumption patterns. This in turn may result in some younger consumers accruing significant and disorganised personal debt. For the providers of financial services, this presents opportunities to attract and educate new or switching customers, but at the same time, the reality that many younger consumers are setting themselves up for several years of extensive personal debt.

Key Words:
Mental budgeting, younger consumers, money management and debt

Introduction

Research into how students manage their finances has been explored in the past both within the UK (e.g. Scott, Lewis and Lea [3]; Callender and Kempson [5]), and the rest of Europe (e.g. Vicenzi, Lea and Rumiati [6]; Lebens and Lewis [7]). In the UK, interest has been particularly evident over the past 10 years, as changes to student funding including the phasing out of maintenance grants, and the introduction of student loans and tuition fees led to the need for higher parental financial contributions and higher levels of student debt. The average debt for a UK student on graduation is now around £6000, compared to just £1,000 in 1992 [8]. Results from previous studies suggest that students' initial intentions on starting their studies are to manage their finances and avoid the use of credit. However, over their years as undergraduates and as borrowing becomes a necessity, they accept excessive debt as inevitable, and careful financial planning and money management in the short and the long term is less likely to take place.

Heath and Soll [9] explored the concept of mental budgeting in relation to consumer decisions. They argued that "*consumers budget portions of their total resources to separate mental accounts (e.g. entertainments or household expenses) and then track expenses against the budgets. As expenses are incurred, they deplete the funds available in their account, which makes future purchases less likely"* (p. 40). In their study, they focussed on how mental budgeting can lead to over- or under-consumption of some goods, as consumers

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manage and use different allocated pools of money. As an example, they cite a male consumer who, having been unsuccessful in buying a pair of slacks (a planned purchase), spent a similar amount of money on a sweater that he would not normally have purchased. He *could* have reallocated the money elsewhere but instead made a purchase on an item that fitted into that budget set (i.e. clothing). By setting mental budgets which allocate particular sums of money for particular types of purchases, consumers then keep track of expenses by labelling goods as relevant for particular budgets. Thus a sweater is in the mental budget of clothing, a meal out in the mental budget of entertainment. They argued that, once money had been spent in one of the accounts, their respondents did not necessarily replenish it with money from another budget set but might instead under-consume in that category until all budgets were refreshed or replenished. They linked this behaviour to issues of self-control and purchase rationalisation. They suggested that some consumers stick rigidly to their budget sets, and therefore under-consume, in order avoid actual or perceived weakness or lack of self-control. On the other hand, other consumers will justify a purchase using money from a different budget set through "hedonic posting" – "*posting items in a way that satisfies short-term interests and skirts the budget*" (p. 51).

All previous studies into students and the way they manage and spend their money have commented on the lack of formal financial planning amongst most of their samples, despite the fact that students in the UK have limited incomes and a high reliance on grants, loans and credit facilities. As Morgan, Roberts and Powdrill [10] commented: "*Neither male nor female students managed their money with great ability or care. Both men and women rated their money management skills as poor, neither planned for social or luxury expenditures to a great degree and the majority reported that they did not plan for essential expenditures*" (p. 26). What is not clear, however, is whether these money management skills related to a formalised system of planning and budgeting or whether there was any level of mental budgeting in evidence.

In order to broaden and develop the focus of previous research, the respondents in this research included sixth form students prior to university, young people who chose to enter full-time employment instead of higher education as well as full-time students at university. This current study seeks to explore the extent to which these young consumers engage in mental budgeting, and the effect that this may have on their spending and consumption.

Research Questions

This research explores younger adults' current money management, and how this may impact on their future opportunities and behaviour. In particular, it is intended to explore:

1. how younger people manage and budget their day-to-day finances;
2. their preconceptions and experiences of avoiding or coping with manageable and unmanageable debt;
3. the similarities and differences in relation to money management and debt between sixth form students, university undergraduates and young full-time workers.

Methodology

As an exploratory study, this research has been based on in-depth interviews and focus groups, carried out in a small, relatively prosperous university city in the South West of England, and a small university city in the North West of England. The geographic locations were selected in order to provide a reasonable geodemographic spread given the small sample size. Respondents were recruited via contacts with local schools and universities.

		South West	North West
Sixth form students	Mixed focus groups (6-7 participants) Depth Interviews	1 3	2 2
University undergraduates	Mixed focus groups (6-7 participants) Depth interviews	3 5	2 5
Full-time workers	Mixed focus groups (6-7 participants) Depth interviews	2 6	1 4

The sixth form students were from three schools – one in the South West and two in the North West. The university students in the South West attended different universities throughout the UK, whilst those in the North West were all at the same university. The full-time workers were mainly skilled or semi-skilled – hairdressers, mechanics, trainee electricians and sales personnel.

Qualitative methods were used in order to gain a "*rich and detailed description, understanding and insight*" (McGivern [11]). Focus groups allowed discussions to develop amongst the participants and enable comparisons and interpersonal exchanges to be observed, whilst the individual interviews enabled a deeper probing of more sensitive issues to do with money management. All the focus groups and interviews were tape recorded and transcribed. The transcriptions were then coded in order to identify links and generate findings.

Findings

Sixth form students - This group of respondents appeared to be careful with their money. They usually have a relatively low income (either an allowance from their parents and/or wages from part-time work), but tended not to over-spend. Those intending to go to University all planned to work over the summer months between school and higher education in order to have some savings before they started at University. The females in this group tended to organise and plan their spending more than the males, and were more worried about being or getting into debt. All of this group anticipate that most of their student loan will be "spending money" - used for buying clothes, books, music and food, as well as funding their social life. They also expect that they will be heavily reliant on financial support from their parents for the larger expenditures such as rent, fees and computers. They envisage that they will be careful with their money at University but not at the expense of "having a good time", which was seen as a very important element of their student experiences.

As Elizabeth comments[2]:

> "*I will keep a record of what I spend and the amount of money I have in the bank so that I can plan how much I allocate to each thing I want…If I want something like a new haircut or a new top, I will probably cut back on the week's food. It is more important for me to buy cheaper food than have no money for going out*"

[2] All names have been changed to ensure anonymity

George plans to go to University in his home town and will therefore continue to live at home:

> "*I will combine the money I earn from jobs with the student loan I take out and divide it into weekly amounts. I will then work out how much money I need to pay every week, like the £25 board for my mum, petrol and going out, and extra spending on books and things like that. I will try not to go over the amount I allocate to each thing, and aim to have some money left at the end of each term*"

These sixth form students are quite adept at money management and budgeting, recognise the value of having savings and are averse to being in debt (even though they also acknowledge it as inevitable once they become University students). They all currently have a bank account and some form of savings and have a structured approach to managing their income and outgoings. As they all lived at home, their money was spent on personal items (clothing, entertainments, gifts, music etc.). They have a basic understanding of the student loans system and the financial support they can expect from their parents, yet are completely naïve about the reality of the expenditures and financial commitments that being a student entails. As Elizabeth commented: *"University is supposed to be fun and you can never borrow money this cheaply again, so you may as well make the most of it and enjoy it*".

University Students - This group includes students both in North West, and those whose home is in the South West but who study at other Universities throughout the UK. All of these respondents had or expected to have extensive debts as a result of their years as full-time students. In the majority of cases, these students were reliant on parental support for payment of tuition fees and/or accommodation costs. Where possible, they seem to avoid taking on paid part-time work during term time, as the following discussion illustrates:
John: "*I don't want a job. I would rather relax or go out in my free time. I think it would be hard to juggle Uni, socialising and having a job*."
Lisa: "*I've tried to avoid getting a job, for similar reasons to John – I just think that I should make the most of Uni, not waste time working*."
Clare: "*I think it would definitely interfere with my studies. My parents are not keen on the idea. When money gets tight I think they would prefer to give me some rather than me getting a job. I don't have as much time as I would like for going out as it is. If I had a job I think I would find it impossible*."
Rachel: "*Well, I could do with the extra income, but I don't really want to get one*."

Whilst they have usually worked out a plan for budgeting their money, most find it difficult to stick to. This was particularly common amongst those students living in cities where the cost of living is higher (for example, three respondents went to universities in London and one in Oxford). All the students recognised that a student loan was an essential part of their undergraduate lifestyle, even though most had significant financial support from their parents as well. However, they were the least worried of all the respondents about getting into debt and tended to talk about any debts incurred, whether through student loans, overdrafts or credit card expenditure as "an investment". For example, when asked whether debt worried him, John replied "*No, not really. I see it more of an investment than a debt – particularly the student loan*."

The interviews with first year students in the first month of their studies shows a worrying shift in behaviours, with some admitting that all their intentions of money management disappeared after the *first week* at University and any planning and budgeting had stopped.

They had spent money on text books, joining societies, socialising and "*buying the sort of food we had at home*" (Danny), and were already less aware of their financial situation than they had expected to be.

By the final year of their studies, students were "debt-blind". They already had large overdrafts and had accessed all of their credit possibilities. Most were unable to identify exactly how much debt they had, and it was not perceived as an issue of concern. When asked whether debt worried them, the participants in one focus group commented:
Michelle: "*I have become used to debt now. It worried me in the first year, but not now*."
Clare: "*Debt does worry me a bit. But most students get in debt, so it doesn't seem a serious problem – just the norm*."
Matt: "*My debt doesn't worry me really. It might do in the future, but for now I don't think about the affects of the money I spend*."
Claire: "*The way I see it, I will be earning more with a degree than if I didn't have one, so the debt now is just an investment for the future.*"
Laura: "*That's a good point – it makes me feel better about my debt, anyway!*"

There were no significant differences in attitudes or behaviour towards money, credit and debt between male and female students, except that the female students tended to spend more on clothes. *"If I'm going to go out and have some fun, I need to be wearing the right clothes to do it in*" (Anne). There was little evidence amongst the groups interviewed of budgeting on a day-to-day basis - they have access to money through overdrafts and loans but no sense of allocating it beyond the imperatives such as rent and student fees. Lisa's comments were fairly typical: "*I always start each term with good intentions, but they soon go to pot and I start spending money on my Switch* [debit card] *and forget about it. I very often do not have a clue how much money I have in my bank account*." Alan lives at home and has no financial commitments for rent, food or fees, which are paid for by his parents. He still has debts of £5,000 from travelling during his gap year: "*I sometimes feel guilty spending money – but I still have to have a good time and go out*."

Young People in Full-Time Employment - These respondents were those that had decided in their last year at school that they did not want to go to University but would rather earn a salary and become full-time employees straight away. The majority of this group did not live at home, most living with other young people sharing a rented house. They all tended to manage their money well, although the majority were unhappy about the low salaries they received. Although their attitudes to debt varied slightly, this group was the most "debt-aware" - they recognised how easy it would be to get into debt and then find it hard to get out of.

Lisa, who has worked as a secretary for the past four years, felt that "*overdrafts are a bad idea. They tempt you into spending money you haven't got. I've never been into my overdraft and hopefully never will, as I don't want to get into debt*". She is currently trying to save enough money for a deposit on a house, which acts as an incentive for her to pay bills promptly and stick to her budget: "*If I can't afford something, I just won't buy it – which can be hard sometimes*".

Although all of this group thought the prospect of being in debt was not one they relished, they agreed that they would consider borrowing money in the future if it meant being able to buy expensive items such as cars and holidays now, rather than having to save for them. This group also managed their finances more effectively and had a sense of how much available money they had at any one time and what it would or could be used for.

Summary

Using the material from the focus groups and depth interviews, it is possible to identify the similarities and differences in money management between these 17 to 24 year olds. Most of respondents felt that they "managed" their money but very few felt they managed it well or effectively. Although they claim to make few unplanned purchases, when they are out socialising they are likely to spend more than they had intended - some commenting that it was easy to do now that many clubs and pubs will provide a cash-back facility if debit cards are used to pay for drinks. Perhaps rather worryingly for academics, a major reason given by students for going to or being at University is to "have fun, have a good time" and "get a good job afterwards". Whilst choice of degree scheme was important, the social potential of prospective Universities, as well as the local cost of living was also critical - "*I wouldn't go to London - I've heard drinks cost £6 there!*" (Rachel). Those in full-time employment chose not to go to University because they didn't want further commitment to academic study, and also relished an independent income. University students are the least worried about being or getting in to debt, whilst those in full-time employment are the most worried. The general consensus amongst University students was that they have accepted that they will incur extensive debt as an inevitable part of their experiences. They do not treat loans or overdrafts as "real" debt but merely as a long-term investment. None of them showed undue concern about how debts of several thousand pounds may affect their lifestyle and choices in the future. For those in full-time jobs, however, debt is seen as very real and should be avoided where possible - the prospect of long-term debts with accruing interest charges is often enough to deter them from contemplating over-reliance on credit cards, loans or overdraft facilities.

Discussion and Conclusions

This study, although relatively small scale, supports and further develops other research into young people and their management of money. In particular, the opinions and behaviour prior to and through University years suggest that young people start with the very best of intentions - they recognise that being a student means budgeting in a new way and will not necessarily be easy. For all of this group, drinking and socialising is crucially important – and this is where their good intentions and financial planning are likely to be overtaken by the experience of "having fun" at any expense. So, in terms of managing their day-to-day finances, it would appear that many young people have a desire and ability to plan their purchases, but this prudence recedes when they are out socialising and drinking alcohol.

There may be links between young people and their debt, and issues of control and self-control. Seligman [12] was one of the first and most prolific researchers into the concept of 'learned helplessness'. In his terms, learned helplessness refers to three interlocking factors: "*first, an environment in which some important outcome is beyond control; second, the response of giving up; and third, the accompanying cognition: the expectation that no voluntary action can control the outcome"* (p. xvii). He suggests that '*organisms, when exposed to uncontrollable events, learn that responding is futile*' (p. 74). Through multiple experiences where the individual has no control, such as those associated with failure or trauma, an individual learns that it is futile to try and exert control. Over time, this leads to passivity and a lack of endeavour. The individual reaches the stage where control is not exerted even in situations where it is available – helpless victims enduring a great deal of avoidable suffering (Baumeister, Heatherton and Tice, p. 43 [13]). Whilst not wishing to present indebted students as "helpless victims", it is possible to speculate that once their debt reaches the stage of over-commitment (i.e. some repayments are made late), or becomes unmanageable (i.e. all repayments are late and in arrears - National Consumer Council, p. ix [14]), these consumers adopt a "helpless" approach to the situation. Their level of debt is such that they are unable to make all or any repayments, the debt is out of their immediate control – with the consequence that they continue to maintain their preferred spending and life-style levels and "give up" on the debt.

The sixth form students and full-time workers, by thinking about and planning their finances, showed an element of mental budgeting in their behaviour. Although they did not articulate their planning in such terms, they tended to compartmentalise their income into budget sets ranging from fixed inflexible categories (such as rent, savings or car tax, which tended not to be used for anything except the intended purpose) to personal categories such as clothing, entertainment and food. They felt they generally managed these latter sets well, displaying a level of self-control over their consumption choices and accepting that once a budget set was depleted, they would wait until the overall budget was replenished rather than switch money from one set to another. They seemed prepared to under-consume in order to best manage their money, and avoid going into debt or extending existing credit. Amongst full-time students however, their mental budgeting tends to consist of two sets – fixed, inflexible categories and "other". Whilst they may have had mental budget sets in the past, because of their limited and sporadic income, any realistic budgeting attempts quickly disappear once they are in debt and once they have established access to credit or loans. They have a sense of needing a certain amount of money each week for necessities such as food and travel, but are prepared to under-consume in some areas - by going without meals or getting a lift to university - if it means that they can still afford to go out to clubs and pubs.

In terms of the relevance and responsibility of marketing towards these younger consumers, there is somewhat of a dichotomy. On the one hand, marketing is used effectively in the commercial, financial and social sectors to advise and support young adults, recognising the issues involved in the management of their money. This can be evidenced through stores and banks offering discounts or special packages for students, for example. On the other hand, the temptation of free or discount alcoholic drinks, as well as "cash-back" facilities, in pubs and clubs arguably encourage this age group to be reckless with their money when out doing what they love best – "having fun". Marketing can be particularly relevant in encouraging younger people to make reasonable choices about how their money is spent and how to manage credit and debt sensibly. However, it also risks being criticised in promoting a life of over-consumption and over-spending. These issues will no doubt be of interest to policy makers (and parents) but from a marketing point of view, it raises the question: to what extent do we, as marketers and financial services providers, have some responsibility for potentially creating a generation of consumers who will constantly live in debt, and if so, what does this hold in store for the future?

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