

# SAVE NOW, PLAY LATER

*\* What you can do to reverse  
the national spending binge,  
one kid at a time.  
by Sara Aase*



In the 1990s, the rate of bankruptcy filings by those 25 and under increased 96 percent, making college-age students the fastest growing category of bankruptcy filers.

In the early '90s an acquaintance of mine, probably all of 21, filed for bankruptcy. We were both in college and struggling with credit card debt. Little did I know he was riding the edge of a tidal wave. In the 1990s, the rate of bankruptcy filings by those 25 and under increased 96 percent, making college-age students the fastest growing category of bankruptcy filers.

The trend sparked the concern of economists, academics, government officials, and bankruptcy judges. "In the mid '90s, the economy had never been stronger, and per capita income was up across all groups," says Lewis Mandell, a professor of finance and managerial economics at SUNY Buffalo School of Management. "At the same time, bankruptcy rates were going through the ceiling."

### Youth literacy still lags

So far, the trend isn't slowing. But why is it hitting young people especially hard? The reasons are multifaceted, but primarily boil down to this: Over the last few decades, marketers have exponentially increased advertising to young people—from birth to age 25—for clothes, food, entertainment, and even financial products like credit cards. But at the same time that their purchasing power and economic influence has grown, their sophistication about money—often called financial literacy—has not.

Consider: every two years, Mandell's group, the nonprofit, Washington DC-based Jump\$tart Coalition for Personal Financial Literacy, quizzes thousands of 12<sup>th</sup> graders around the country about the concepts of income, money management, spending and credit, and saving and investing. The teens have yet to score a passing grade. In fact, students' average scores were highest in 1997, the survey's first year, at 57 percent. Scores have since declined to 52 percent.

Now picture these same young adults on their own. On college campuses, credit card companies are waiting to bridge the sizable gap between their wants—like the latest CDs or clothes—and their now significantly shrunken incomes. According to the book *Raising Money Smart Kids: What They Need to Know About Money—And How to Tell Them*, (Dearborn Trade Publishing, 2005) 83 percent of undergrads

have at least one credit card and carry an average balance of \$2,327. Twenty-one percent had balances between \$3,000 and \$7,000. By the time they graduate, they have an average of \$20,402 in combined education loan and credit card balances—a fine hole they'll be digging themselves out of for many years.

With its biennial quizzes, Mandell's group tries to highlight the need for more comprehensive financial education in schools. Mandell is concerned that so many students seem unable to retain or apply the money management skills they need. "We're very concerned about it, because in the 21st century where pretty much all safety nets have been cut, mistakes you make may be really disruptive to your plans and hopes."

### Overspending, a nationwide problem

It's not just kids who need help. Home foreclosures are on the rise, hitting one in every 1,117 U.S. homeowners. Personal bankruptcy affects one in 60. And overall, we're spending too much

and saving too little. The Federal Reserve measured the consumer ratio of debts to assets for the first quarter of 2006 at 18.7 percent. In the '80s, that ratio was around 13 percent, and in the 1950s, it was 7 percent. Likewise, the percentage of after-tax income we spend paying down that debt is also rising—it was at nearly 14 percent for the first quarter of 2006, up from 11 percent in 1980.

Credit deregulation in the '70s has had two profound effects on personal finance, says Judge John Ninfo, a bankruptcy judge in Rochester, New York. First, as the idea of "buy now, pay later" caught on, too many people didn't realize there was a catch—a big one. "In the old days, you didn't have to teach financial literacy because you couldn't get credit unless you could afford it," Ninfo says. Deregulation meant too many people signed up for "free money" without reading the fine print. They didn't understand how interest would affect the total price they paid because they didn't do the math, Ninfo says. Today, the average U.S. family has approximately \$9,000 in credit card debt. "At 20 percent

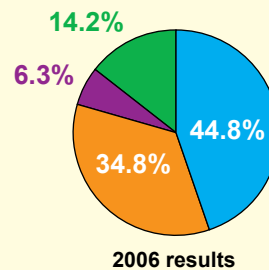
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### 2006 JUMPSTART SURVEY

High school students showed that most have a very poor grasp of the concept of long-term returns. Here's a sample from the survey:

*Kelly and Pete just had a baby. They received money as baby gifts and want to put it away for the baby's education. Which of the following tends to have the highest growth over periods of time as long as 18 years?*

- a) A U.S. government savings bond
- b) A savings account
- c) A checking account
- d) Stocks



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interest, that's \$150 a month in interest payments alone, or \$1,800 a year before you pay a penny of the principal back," he says. Easy credit has also dampened people's saving habits. "People used to save as much as they could for emergencies and for things they could plan for, like car or roof repairs," Ninfo says. "Now not only do they not save for emergencies, they don't save for the things they can anticipate, and they end up paying twice as much for them."

According to the Fed, people start to get into trouble when they amass debt that's more than 30 to 40 percent of their gross income, because interest rates make the debt grow too fast for their income to keep up. In late 2005, a survey of low- and middle-income households (*The Plastic Safety Net: The Reality Behind Debt in America*) found that 7 out of 10 used credit cards to pay for everyday items such as groceries, rent, mortgages, utilities, and car repairs. Ninfo has seen firsthand what often happens next. He has noticed a surge in bankruptcy applications since the '90s that has yet to let up—and one that ensnares plenty of teachers, doctors, and lawyers. Appalled that many applicants didn't understand how they ended up in his court, in 1997 Ninfo launched a financial literacy program—credit abuse resistance education program, or C.A.R.E.—since adopted by high schools and community colleges in 32 states. Says Ninfo, "How are families supposed to sit down and tell their kids about personal finance when they don't understand it themselves?"

### What can you do?

Enough gloom and doom. There's one magic word that, if passed on as a mantra to the next generation, will have a phenomenally positive financial effect. That word is "save." Even if you weren't brought up with the habit, here are some lessons from experts, teachers, and young investors from around the country.

### Attitudes set expectations, habits

How do you feel about money? About spending it, saving it, and allocating it? Chances are you picked up these attitudes from your parents and other adults when you were quite

young. "Even if you think you're not teaching kids anything about money, you are," says Janet Bodnar, deputy editor of *Kiplinger's Personal Finance* and author of *Raising Money Smart Kids: What They Need to Know About Money—And How to Tell Them*. "When you're discussing whether to get a new car or get the old one fixed, they're listening—they're picking up on that."

Inevitably, you'll impart both good and bad lessons along the way. Don't worry—kids learn from both. Bodnar's family, for example, didn't have a lot of money, so she learned to be frugal, as well as to strive for goals, such as earning a scholarship to college. But their insistence on buying what she needed instead of giving her an allowance to manage initially hindered her shopping savvy when she got her first job.



At age five, she added Tootsie Roll to her portfolio of Wrigley, Mattel, Disney, and Hershey stocks.

Michael Berman's family liked to play the lottery and weren't good money managers—except for his grandfather, a successful stock market investor. Today Berman spends most of his time running a local

investment club offered through the National Association of Investors Corporation, a nonprofit organization based in Madison Heights, Michigan. He didn't pick up his grandfather's habit until his early 30s, but has since been able to semi-retire, at age 48, from his stock market earnings. "While my grandfather was alive, I showed very little interest in the subject. But I'm sure his stories had a huge influence on my understanding of the industry. It was probably one of those subliminal things."

Bodnar advises parents to concentrate on building a solid foundation by teaching kids the following:

- Save for a goal.
- Manage a cash allowance.
- Manage a checking account and ATM/debit card.
- Calculate how much money grows over time according to interest rates.
- Avoid and/or pay off credit card debt.
- Compare prices and consider questions of value.

### What is money for?

When kids start requesting toys, it's an opportunity to start simple financial lessons, Bodnar says. "Can I have this game or toy that I see on TV?" is a financial question," she says. "The financial answer should be no, with a reason." ("You don't need it," or "It will just break right away," are good reasons, she says, because they start to teach the concepts of needs versus wants and of assessing value.) When a child asks for a treat, let him hand the cashier the money. This starts teaching them the idea that we exchange money for other things.

### Encourage saving

Make savings visible and tangible for kids as young as three or four by setting up a system where they can see and access their growing stash (such as a jelly jar). Encourage them to set a short-term savings goal that's meaningful to them. A goal gets them excited about the power of saving. You can also point to the bank as a way to illustrate that you, too, have limited sources of income. "Kids see you go to a machine and push a button, and they think it's magic," Bodnar says. "Say, 'the bank is like a big piggybank for mom and dad, and sometimes it's empty until you put in your paycheck.'"

When your kids are older, offer to match their savings as an extra incentive. Or provide a family goal that you all save toward, such as a special trip. A tangible goal makes it easier for kids to prioritize their habits in favor of saving.

Before she took a financial literacy course, Chicago high school senior Catrina Patton says she ate out with friends every week. Now she's saving for books and other expenses she knows she'll have at college. "Now I tell them I'll go out with them at the end of the month, or I bring my lunch," Patton says. "It helps me save a lot of money."

### Start an allowance

At about age six, start an allowance, Bodnar advises. Clearly delineating what expenses kids need to cover, such as a birthday present for a friend, teaches them how to shop, compare prices, consider value, and save for spending goals. Bodnar's book outlines a variety of rules or scenarios:

- Require kids to save 10 percent of their income.
- Encourage them to spend their bills but save their change.

- Have your kids divide their money into piles for savings, spending, investing, charitable giving, or other categories that make sense.
- Don't tie an allowance to everyday household chores that everyone is expected to do (this encourages a mercenary approach to life), but do offer to pay for extras you might pay someone else to do, such as washing windows.

### Encourage savvy spending

When your kids are in grade school, Bodnar advises divvying up the grocery shopping list and assigning each some items to buy. Show them how to look for the lowest unit price instead of the lowest price per package. Have them blind-taste similar soft drinks to see if they can tell the difference between Coke and a generic brand. Discuss commercials—are the foods and toys they advertise as good as they look on TV? If you like to hit thrift stores, garage sales, eBay, or other discounters, show your kids how a little looking often can save them big bucks over full retail price. Children will likely show lots of interest in learning about money at this age, but don't go overboard by plying them with too many lessons—especially ones that involve tedious amounts of arithmetic—or your good intentions might backfire.

### READ UP

**There are scores of investment gurus to follow, Peter Lynch and Warren Buffett being two of the most-cited. *BusinessWeek* recommends these reads. For those just starting out:**

- *The Only Investment Guide You'll Ever Need*, by Andrew Tobias (Harvest Books)
- *Informed Investor*, by Frank Armstrong (American Management Association.)

### Bonus picks:

- *The Intelligent Investor: The Definitive Book on Value Investing, Revised Edition*, by Benjamin Graham with Jason Zweig (Harper Business Essentials)
- *Common Stocks and Uncommon Profits*, by Philip Fisher (Wiley)
- *A Random Walk Down Wall Street, The Time-Tested Strategy for Successful Investing, 9<sup>th</sup> Edition*, by Burton Malkiel (W.W. Norton)

### Teach budgeting

By the early teen years, a universe of spending opportunities opens up, from class field trips to dates, dances, movies, and clothes. For tweens and teens ages 12–19, spending has doubled every 10 years for the past three decades and tripled in the '90s. They now spend \$170 billion per year of their own and their parents' money. This is where the early foundation you laid kicks in and helps them (and you) maintain a grip. One of the best things you can do at this age is boost your kids' allowance as well as the items it must cover, Bodnar writes, such as gas for the car, part of the car insurance, and most of their wardrobe, in order to give them more practice in managing money. More than ever, she says, kids will need your help in distinguishing wants from needs and establishing and meeting spending and savings goals.

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At this age, Bodnar suggests that parents help their children:

- Monitor their spending for a month.
- Set savings goals and write them down.
- Write a list of needs and wants, prioritize it, and attach a budget to each item.

Some parents have found that letting their kids—with oversight, of course—pay the household bills for a month really opens their eyes to how real-world finances work. Doing this before they leave home provides them with a tremendous advantage. “Teenagers today are not really aware of finance, of keeping track of their money, and budgeting for savings,” says Latasha Hubbard, a Chicago-area high school senior who credits her ability to budget and save to her mother and to local programs in her area. (Hubbard participated in a financial literacy program and spent two consecutive summers working at different financial firms through the Chicago Summer Business Institute.) Hubbard, who already had \$1,300 saved toward college expenses last summer, says her friends are trying to emulate



her saving habits. She plans to help more people from her community with their finances once she earns her degrees in business or finance and corporate law.

### Crunch the numbers together

Don't forget to teach your kids how to balance a checkbook and use an ATM card. (Co-sign to help them open an account if they're under 18.) Explain how a bank works, including applicable fees and overdraft charges. You don't want them to be out on their own thinking that as long as money comes out of the ATM, everything's okay!

If you haven't revisited the lessons of compound interest, the teenage years are the time to explore the issue through savings and debt calculators. If you have a 529 college savings account in their name, its balance is the perfect illustration of the power of return on money saved or invested over an 18-year-time period. Set up an IRA as soon as your child has earned income—from mowing lawns, babysitting, or other jobs, again emphasizing the return it will generate for them down the road. “Now's the time for them to really start socking

## TALKING INVESTING

by Sara Aase

**Tina Dressel, 22, started investing in the stock market when she was 13, with part of the money she'd been saving since she was eight. Her portfolio of seven stocks was worth about \$8,500 in the summer of 2006. Here are some of her tips for other young investors:**

- Start putting money aside for investing. She started with \$200 or \$300.
- Start with a company you know or something you can relate to. Dressel's first stock, for instance, was Applebee's. “At the beginning it was helpful to have some companies where I could physically go and see if they're doing things well, are they growing, things like that.”
- Read up on companies on Yahoo! Finance.
- Join investment clubs to learn how to read earnings reports and performance ratios.
- Discuss stocks with people you trust who know more than you. “My dad would ask specific questions when I was starting out about things I thought were good or

bad about a stock.”

- Don't be afraid. “If you can get decent background on your company, you're probably not going to lose all your money. Put a couple hundred dollars in. Taking a little bit of risk for the sake of learning can really teach people a lot.”

**Here are more tips from *The Motley Fool Investment Guide for Teens* (Fireside, 2002):**

- Shop around for brokerages or consider investing directly in a company through its dividend reinvestment plan. If you're opening a custodial account as a minor, ask for a break on fees.
- Be bullish about the overall market, but bearish about individual companies—choose carefully.
- Look at a company's market capitalization (worth of all outstanding shares), not its individual stock price, to get a sense of its value.
- Pick no more than 10 companies to follow, and diversify a bit—i.e., choose a few large companies, small companies, and foreign companies.

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—Lewis Mandell, professor of finance and managerial economics SUNY Buffalo School of Management

it away," Bodnar says. The beauty of it? They don't even have to think about it if they don't want to—and it's very likely they won't—for many years. Meanwhile, that money could grow into a million dollars by the time they retire, say the authors of *The Motley Fool Investment Guide for Teens* (Fireside, 2002). But it's up to adults to illustrate this lesson, because, unlike credit card offers, this message is not inundating their mailboxes or plastered on every TV screen and major sports stadium.

### College years

Speaking of credit cards, discourage your kid from signing up for one in college (and *don't* co-sign one). Credit card companies are eager to win young customers because they anticipate that students will pay interest on late-night pizzas for many years. According to *The Motley Fool Investment Guide for Teens* colleges make extra money by selling lists of student's names to credit card companies, and some even take a cut of every dollar charged on those new accounts. In short, Ninfo says, they are profiting at students' expense. If kids do get into credit trouble, Bodnar writes, don't bail them out, but perhaps offer them a "consolidation loan" for far less interest than they would pay to credit card companies.

College often thrusts the real world onto kids before they're prepared to handle it. While that's not necessarily a bad thing, be prepared to repeat all the good lessons you've already instilled, such as encouraging them to budget and to understand what they are paying for and what you are paying for. Even if you think your kids know a lot, their money management skills are still new.

### Bonus: spark an interest in investing

Kids who want to build their own investment portfolio will likely do even better in the long run than their non-investing peers. Tina Dressel, for example, is a 22-year-old MBA student from St. Louis with no credit card debt and \$8,500 in an investment portfolio she started when she was about 13. Dressel expects to leave that money alone until she wants to buy a house.

Likewise, Berman's nine-year-old daughter is also a budding investor. At age five, she added Tootsie Roll to her portfolio of Wrigley, Mattel, Disney, and Hershey stocks. Next year, Berman hopes to get her interested in evaluating companies online. Berman's goal for his daughter is to pass along the value of financial independence. The great benefit of delayed gratification today, he says, is that as an adult, she should "be able to do what she *wants* to do, not what she *has* to do." ●

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