CHAPTER ONE

Reduce Your Spending

Chapter Summary
This chapter focuses on helping you learn the fundamental financial skill of controlling your spending. It starts by showing you how to track your spending and identify where you might cut back on your expenses. It discusses how to develop new spending habits and provides a range of strategies for doing so.

This chapter begins a discussion of personal money management that will continue through chapter 5. The goal of this first part of the book is to help you gain more control over your money and learn to make healthier financial decisions.

Many people feel anxious and out of control when it comes to their finances—money is the cause of a great deal of the stress in our lives. In fact, many people can't even bear to face their financial problems since their feelings of shame, fear, and stress make those problems seem insurmountable. If that sounds familiar, the solution lies in learning better money management skills that will inspire you to face your situation head-on and start making real changes. The purpose of this book is to help you do that.

Since managing your money begins with reducing your expenses, in this chapter I'll focus on explaining how you can start getting your spending under control. You may wonder why I'm starting there, rather than showing you how to increase your income right away. (As you'll see later, I do have lots of suggestions about how you can earn more money.)

I could start by showing you how to increase your income if your financial problems could be magically solved by earning a little more money. However, if your expenses aren't under control at this point, adding more money won't help; it will simply increase the size of your problem. (If you don't believe me, consider how many millionaires have gone bankrupt—lots!) If you're struggling financially, learning to control your expenses will be the first step in developing a healthier relationship with your money.

Track Your Spending Exercise

If you're like most people, you've thought a lot about how you might earn more money. You might also have said to yourself, "Gee, I really *should* reduce my expenses." However, have you considered what it would really take to spend less? Learning to control your spending is the first and most fundamental financial skill—if you lack this ability, nothing else you do will help very much (like all those millionaires who went bankrupt).

To start learning how to control your spending, you need to know where your money is going. Here's an exercise that will help you figure that out. (If you already know exactly where your money is going every month, congratulations! Few people do. However, I'd suggest that you complete this exercise anyway—you may learn something new.) After explaining how to do the exercise, I'll describe how to use your results to understand your spending habits better.

This exercise starts with tracking your family's spending for at least one month—and ideally for two or three months. Proceed as follows:

1. During the month, write down the amount of every item your family spends money on, including a description of each expense so you'll remember what it was for.
2. At the end of the month, go over the expenses you recorded and divide them into two categories, fixed expenses and flexible expenses:
   - **Fixed expenses** are expenses that you have little or no control over (like your mortgage)—you *must* spend that amount of money this month.
   - **Flexible expenses** are expenses over which you have at least some control (like your food bill)—you *could* spend less, if you could figure out how to do it.
3. Go through the expenses in each category and lump them into logical subtotals, such as food, clothing, insurance, utilities, and so on. (The specific categories don't matter, as long as they make sense to you.)
4. Create a two-column table to add up your fixed and flexible expenses for the month. Under each column, list the subtotals. (If you do this exercise for more than one month, create a table for each month.)

Table 1 shows an example of what your first monthly spending table might look like. Of course, your expenses might be very different from the numbers used in this example, so the subtotals shown here may not be the best categories for you to use. It will be most helpful to use subtotals that reflect your own spending patterns. For example, if you're consistently spending money on books, CDs, toys, take-out coffee, or household supplies, then you should show a subtotal for that expense category. (It's especially important to customize your subtotals like this for your flexible expenses.)

If you're having trouble deciding whether an expense is fixed or flexible, lean toward putting it in the flexible column. Resist the temptation to put an expense in the fixed column unless you really didn't have a choice about spending that money this month. For example,

Table 1. Example spending table

Our spending for January

Fixed expenses		Flexible expenses	
Mortgage (or rent)	$600	Food	$500
Property tax	$300	Clothing	$200
Gas	$100	Gas	$150
Insurance (personal and business)	$1,000	Vacation	$200
Car loan	$350	Entertainment	$100
Credit card payment	$550	Cable television	$50
Utilities (gas, electric, water, phone)	$200	Charitable contribution	$150
Student loan	$400	Hobbies	$100
		Child care supplies	$100
		Other business expenses	$200
Total fixed expenses	$3,500	*Total flexible expenses*	$1,750

you could put some of your gas expenses under the fixed column, since you have to buy a certain amount of gas each month. However, don't list everything you spent on gas this month in that column, because some of that spending was probably flexible.

If you do this exercise for just a month or two, you won't account for all your expenses, since some large expenses occur infrequently—fixed expenses such as homeowners insurance, car insurance, and property taxes; and flexible expenses such as furniture, computer hardware and software, and seasonal and holiday expenses. If you want to try to include all your infrequent expenses in your table, you could add them up into two annual totals (fixed and flexible), divide the totals by 12 to get the average cost per month, and add these subtotals to your monthly table.

If you don't have good records of your spending for the last 12 months, then just do your best to estimate these totals, and refine your estimates over time as you track your actual spending.

Review Your Table

Once your first monthly table is done, use it to improve your understanding of your financial habits and circumstances. Ask yourself the following questions:

- **Is my spending level sustainable?** Compare the total of your fixed and flexible expenses to your total income for the month. If your expenses were higher than your income, this is a clear sign that your finances need immediate attention—you won't be able to sustain this level of spending without going deeper and deeper into debt. This book will give you the tools you need to make real changes so that you can start creating a healthier financial future for yourself.

- **What does my spending say about my values?** You work hard for your money, and the way you spend it is an indication of your values. Ask yourself what your spending this month says about what you value most. For example, if you're in debt, are spending thousands of dollars on clothes every year, and haven't saved much for retirement, this shows that you place a high value on current consumption and a low value on providing a comfortable future for yourself.

  Take time to consider how you're spending your money. If your spending behavior doesn't match your true priorities in life, you may want to become more purposeful about how you're using your resources. This can be a powerful motivation for changing your habits.

The Culture of Spending

Unlike in our great-grandparents' generation, spending money now rather than saving for tomorrow has become a fact of life for many people. This habit has been greatly encouraged—if not created—by the culture of spending that has grown up around us. Every day we're bombarded with advertising messages that urge us to spend, spend, spend. All our media—television, radio, newspapers, magazines, billboards, and the Internet—are constantly urging us to spend more. We've even become walking billboards ourselves, since it's become fashionable to wear clothes that prominently feature the maker's name.

We've been trained to accept our role as consumers without question, and most of us own far too many things that we haven't yet paid for. As a result, most people in our culture place a higher value on spending for today than on meeting their long-term financial needs, such as preparing for their children's college education or a comfortable retirement. They don't acknowledge the fact that not being able to provide for their family's future needs is a sign that they're living beyond their means.

When was the last time you heard an advertisement say, "Hey, you! Thinking about spending money? Stop! Don't do it! Save your money instead! This message brought to you by . . . " Wait a minute—who would sponsor such an advertisement? Even your bank can make more money by selling you other financial products than by encouraging you to save. So you'll never hear such an ad because no business can make much money by selling the idea of saving rather than spending.

To change our financial habits, we need to start noticing and questioning all the messages that are urging us to spend. We also need to counter their influence by developing our own internal messages and motivations for saving money instead of spending it.

Don't Show Your Love by Spending

It's natural to love the children in your program and want to show your love in every way you can. The only problem with this natural desire is that too many providers make the mistake of thinking that expressing their love means spending more money on the children. But showing your love *doesn't* mean spending more.

Some providers keep buying more or larger toys every year until their closets, basement, and garage are all overflowing. One provider, Pat from Minnesota, told me that many providers have turned their habit of buying children's items that they don't really need into a "hobby." Certainly, toys are an important part of helping children learn. However, providing a hundred toys won't help children learn that much more than far fewer toys, and it may even be counterproductive.

Are You Spending to Meet Emotional Needs?

Some providers tend to spend money to meet their emotional needs—to express their love, improve their mood, get approval from others, outdo other providers, and so on. If this is your pattern, you're probably aware of how easily it can lead to overspending. Learn to notice when you feel the urge to spend for an emotional reason, and look for another way to meet that need instead.

I'm not saying that you should never buy flowers to brighten up your day, but I do believe that it's healthier to learn how to meet your emotional needs in ways that don't involve spending money.

Once you let go of your emotional reasons for spending money, you can focus on more rational reasons, such as replacing a broken toy, meeting an educational objective, or satisfying a physical need (such as food, housing, or clothing).

The parents of most of the children in your care won't expect you to spend a lot of money on their children. In fact, if you do, they may feel uncomfortable and worry that they won't be able to keep up with you. (If you're not sure about the parents' attitudes, ask them.) The providers who responded to our survey agreed that you don't need to spend a lot to provide a quality environment for the children:

> *Learn to set a budget, and don't let your heart take over and buy too many things just because you love the kids. You have to set limits on holidays and birthdays. It's really important to put the cash away for emergencies before you get into a situation where you have no extra money to spare.*

> *Stop making so many purchases for your business. You really don't need another book or toy. Use the resources you have. You don't need one of each kind of whatever it is you want.*

> *Stop spending money on your business—it's too easy to "nickel and dime" away your cash for new things that you don't really need. I have updated my equipment and environment with quality items—but it's the little stuff that really adds up without adding much to my business.*

> *Stop buying so much stuff for your day care. Most providers I know continually buy junk because it's on sale or a good deal at a garage sale. Then they have too much stuff, and complain that they can't get organized.*
>
> *Save, save, and spend only what you need to. Reduce, repurpose, reuse, trade. You do have to be creative, but kids don't need expensive toys to be happy and keep learning.*
>
> *You can always find ways to save a few dollars here and there. Your day care children don't need the best of everything to stay happy and be well taken care of.*

As Heidi from Wisconsin says, "I've watched other providers spend too much, and I don't want to be like that. I've tried to warn other providers, 'If you start out caring for two or three children, and then expand your program to five or six, don't spend more money. Live within your means.'"

Small Amounts Add Up Quickly

Some providers buy small items for the children whenever they go shopping—candy, small toys, or other treats. Others tend to spend a little bit every day on small discretionary expenses, such as bottled water or takeout coffee. You may be thinking that these little purchases couldn't make much difference—"It's only $10, so why not buy it?" However, this attitude is usually a sign that you're in denial about spending beyond your means. Although each of these purchases may be small, if you're watching your spending, you'll know that they add up quickly.

Being able to resist the urge to spend even a small amount of money is one of the first signs that you're developing wiser spending habits—and over time this change can make a big difference. Let's take a look at how small decisions about spending or saving can add up:

- If you spend $5 a day on takeout coffee or treats for the children for five days a week, 50 weeks a year, it will add up to an expense of $1,250 a year.
- If you instead invest the same amount ($25 a week) in a tax-deferred investment that earns 8% a year, after 10 years you will end up with $19,127 for your retirement.

The difference between these "small" choices is over $20,000!

Nevertheless, some providers assume that it's fine to spend more as long as they're spending the money on items for their business. They figure that they'll be able to deduct all their expenses on their tax return anyway, so they might as well spend the money rather than give it to the IRS. Is that true? Let's run the numbers and find out:

Let's say that you're in a 40% tax bracket (25% federal income tax plus 15% Social Security tax), and you have $1,000 in your checkbook. You're considering spending $100 on an item for your business. If you buy that item, you'll only reduce your taxes by $40. The net effect is that your $1,000 will be reduced to $940 ($1,000 – $100 + $40 = $940). If you had saved the $100 instead, you would still have the entire $100, plus you'd have started accumulating interest that would gradually build your savings.

The bottom line? Regardless of your tax bracket, it never makes sense to spend money just to reduce your taxes. In this example, the provider spent $100 in order to save just $40 in taxes. That's not a very good bargain.

Spending Less Pays Off

In general, providers who earn a higher business profit accomplish this primarily by spending less rather than by charging higher rates. To see why, consider two providers who are caring for the same number of children and charging the same fees. Although they both start with the same income, the one who keeps her expenses lower will always have a bigger profit, and thus more money to set aside for her short- and long-term financial goals.

Strategies for Reducing Your Expenses

Regardless of your income, having a healthy relationship with money means living within your means—keeping your annual spending below your annual income while putting away enough money for your short- and long-term financial goals.

Many providers who are living beyond their means find that it is easier to reduce their expenses than to increase their income. Even providers who earn very little can usually find ways to reduce their expenses by a small amount here and there—and, as we've just seen, those small amounts can add up quickly.

Here are some strategies that other providers have successfully used to reduce their expenses:

- Linda from California asks parents to bring her business supplies from a list that she keeps posted in her home. The list includes items such as scratch paper, card stock, markers, and crayons. At Christmas, she gives parents a wish list of items she can use for her business. (Before that, they were giving her Christmas gifts that she couldn't use, such as bubble bath and perfumed powder.)
- Tiffany from Illinois helps pay for her monthly birthday parties by posting a list of items that she needs parents to bring, such as food, juice, pizza, games, or a veggie tray. For her last Halloween party, the parents brought everything she needed, so the party didn't cost her anything.
- Olga from California says that she keeps her expenses low by being well organized. She keeps careful track of her supplies and materials so that she can avoid buying something she already owns just because she can't find it.

- Roxanne from North Dakota charges parents an annual supply fee of $75. This fee covers her expenses for broken toys, damage to her home, and carpet cleaning, plus supplies such as her hand soap dispenser, paper towels, dish soap, toilet paper, pencils, coloring books, birthday posters, and costumes for the children. She has also saved $500 a year by stopping her practice of giving a treat to the children every Friday.
- Before she buys something, Pat from Minnesota asks herself, "Will this improve my business, will it entice parents to come to my program, or will it not matter?" "Mostly it doesn't matter," she says, and that realization helps her avoid spending money on things that she doesn't need.

Here are some additional suggestions from other providers that you may wish to try in your program:

> *Have parents bring a food item that you can use to prepare a main dish for lunch with the children. Then make enough of that dish so that you can give the remainder to the parents for their family dinner.*
>
> *I can't afford to transport children in my car any more because of the high cost of car insurance. So now I take the children on field trips on the city bus and charge their parents for the bus fare.*
>
> *I suggest that you go to household auctions, where you can often buy arts and craft supplies, games, puzzles, and toys for pennies on the dollar. One year I was able to get all my Christmas decorations for just $10!*

Deposit the Money You Receive Promptly

Unlike an employee who gets a paycheck every two weeks—and may never even see the money if it's directly deposited into her checking account—most family child care providers are in regular contact with money. You may be paid on a weekly basis, or even more often, if your clients don't all pay on the same day. So you may be receiving payments several times a week, and often they're in cash.

This constant flow of money may tempt you into thinking that you have a lot of money to spend, but of course, this isn't true. In fact, your profit may be only a small portion of what you earn.

To overcome the temptation to spend your money right away, put all the money you receive right into your checking account—especially the cash! This habit will help you resist the urge to spend money that you need to cover your expenses.

Rethink Your Habits

Finding ways to save money may mean rethinking some old habits, but just because you've done something the same way for years, that doesn't mean you can't change it.

- Stop buying children's toys and supplies at the retail price; instead, start going to Goodwill, consignment shops, and yard sales.
- Start using the library for children's books and videos rather than buying them.
- Start using dishrags instead of paper towels.
- Stop buying small garbage bags; reuse your grocery bags instead.
- Cut back on eating out and groceries. Eat less meat. Stop buying bottled water.
- Stop smoking.
- Cut back on buying lottery tickets and takeout coffee.
- If you're regularly paying ATM fees or late fees at the video store or library, change your habits to avoid these charges.
- If your bank is still sending you your cancelled checks each month, cancel this service—banks now charge extra for it.

Look online for more suggestions for living frugally—there are many Web sites devoted to living on less, including www.thefrugalshopper.com, www.simpleliving.net, and www.frugaliving.com. To find more resources, do an Internet search for "living cheaply," "frugal living," or "voluntary simplicity."

Little Steps Count

Here are some small steps that can add up:

- Ask other providers for any toys that they are no longer using.
- Ask parents to donate any children's items that they no longer need—toys, equipment, supplies, and so on.
- When you hear that another local provider is going out of business, call her and see if she'd be willing to donate her toys and supplies to you—and if not, whether you could buy them at a discount.
- Put all your change away in a savings jar.
- Buy items in bulk whenever possible—toilet paper, cleaning supplies, light bulbs, laundry detergent, etc.
- Buy the lowest-octane gas available, and don't drive faster than the speed limit (speeding reduces your gas mileage).

- The next time you raise your rates, don't raise your spending; instead, put the extra income directly into a savings or investment account.
- If you donate your old clothes and toys to a charity, rather than selling them at a garage sale, visit the Web site itsdeductibleonline.intuit.com to determine their current value. Then deduct the total as a noncash charity deduction on **Schedule A**.

Look for Big Steps Too

Consider these potential opportunities to reduce your spending:

- If you get a windfall, don't spend it. Whenever you get an extra lump of money, such as a rebate check or an overpayment refund, save it—don't spend it.
- To reduce your insurance premiums, raise the deductibles on your homeowners and vehicle insurance policies to at least $500, and preferably $1,000. Don't spend the resulting savings; put it directly into a savings account each month.
- The next time you're in the market for a car, get a vehicle that has good gas mileage.
- Contact your energy company to see if it can conduct an energy audit on your home. Increasing the energy efficiency of your home can save you a lot of money. If the audit makes a recommendation that would require a large investment, such as installing new windows, consider how long you'll be living in the home to determine whether the payback will be worth it.

Smart Shopping Tips

Here are some tips that can help reduce your spending while shopping:

- Shop alone.
- Make a list before you go, and don't buy anything that isn't on your list.
- Bring a limited amount of cash, and leave your checkbook and debit card at home.
- Identify the stores where you spend too much. Before you visit one of those stores, set a limit on how much you will spend on that visit.
- Eat before you shop for food or groceries.
- Take a calculator with you to the grocery store and add up every item you place in your cart to make sure you don't exceed your food budget. That way you won't be surprised when you get to the register.
- Don't shop if you're in a bad mood—people often spend more to improve their mood.